CHAPTER 8

TAX RELIEF ON DONATIONS TO CHARITY

8.1 Introduction

Individuals receive tax relief on **donations** they make to UK registered **charities.** From 6 April 2010, relief is also available for donations to charities registered in other EU member states, Norway and Iceland. There are two ways in which an individual can obtain tax relief on cash donations to charity.

The first is under the **Gift Aid Scheme**; the second is by direct deduction from salary under the **Payroll Giving Scheme**. This second scheme will be covered when we look at income from employment.

8.2 Gift Aid

ITA 2007, s.414

Gift Aid payments are made **net of 20% basic rate tax**. Assume a taxpayer wishes a charity to receive a total of £1,000. The taxpayer will actually give the charity £800. The charity will then claim back the £200 from HMRC.

Ultimately the charity receives £1,000. It receives £800 from the taxpayer and £200 from HMRC. The taxpayer has received 20% tax relief at source - i.e. the charity receives £1,000, but it only physically costs the taxpayer £800.

If the taxpayer is a **basic rate taxpayer no further adjustment** needs to be made. This means that we can ignore this charitable donation in the tax computation. This is because the taxpayer is entitled to 20% tax relief on his charitable donation and he has actually received this relief at source.

However, if the taxpayer is a **higher rate or additional rate taxpayer** then an adjustment needs to be made within the tax computation. The way we give higher rate or additional rate taxpayers **further relief** on their charitable donations is by **extending the basic rate and higher rate bands.**

8.3 Extending the bands

This is the process by which higher rate and additional rate taxpayers obtain extra relief on their charitable donations. Firstly, we will consider the position of a higher rate taxpayer who makes a gift aid donation of £800 (net).

The basic rate limit for 2010/11 is £37,400 and is extended by the gross amount of the donation to charity:

		£
Basic rate limit		37,400
Add:	Gross charitable payment	
	Amount paid x $\frac{100}{80}$	
	Here £800 x $\frac{100}{80}$	1,000
New basic rate limit		38,400

This new basic rate limit is now used to calculate the tax liability.

By extending the basic rate band by £1,000, we are taking £1,000 of a taxpayer's income and **instead** of taxing that income at the higher rate of **40%,** we are now taxing that income at the basic rate of **20%.** This effectively gives the taxpayer an **extra 20%** worth of tax relief on a gross payment of £1,000.

Illustration 1

Mr Generous has the following income/expenditure for 2010/11

	£
Salary (PAYE £24,000)	90,000
Building Society interest	8,000
Donation to charity under Gift Aid	12,000

Here is how we deal with the charitable donation in the tax computation:

	Non Savings	*Interest*
	£	£
Employment income	90,000	
Interest (x $\frac{100}{80}$)		10,000
Less: Personal allowance	(6,475)	______
Taxable income	£83,525	£10,000
New basic rate limit		£
Original		37,400
Add: gross donation		
12,000 x $\frac{100}{80}$		15,000
New threshold		£52,400

Tax	£
52,400 @ 20%	10,480
31,125 @ 40%	12,450
83,525	
10,000 @ 40%	4,000
Tax liability	26,930
Less: PAYE	(24,000)
Tax on interest	(2,000)
Tax due	**£930**

When calculating the tax liability of a taxpayer liable to tax at the additional rate, both the basic rate and **higher rate limit** will be extended by the gross amount of the gift aid payment. This ensures that the same amount of income is taxed at 40%, as would have been the case if the base rate limit had not been extended. The wealthy taxpayer will therefore receive an extra 30% relief on the payment.

Illustration 2

Mr Kindly has taxable income (all non-savings) of £170,000 in 2010/11. He makes a donation to charity under the gift aid scheme of £1,600.

Mr Kindly's income tax liability will be calculated as follows:

Taxable income	£170,000
Original basic rate limit	37,400
Add: gross donation – 1,600 x $\frac{100}{80}$	2,000
	39,400
Original higher rate limit	150,000
Add: gross donation	2,000
	152,000
Tax	
£39,400 @ 20%	7,880
£112,600 @ 40%	45,040
£18,000 @ 50%	9,000
	£61,920

8.4 Gift Aid – transitional relief for charities

Before 6 April 2008, the basic rate of income tax was 22%. This meant that:

a) individuals grossed-up their Gift Aid donations at 100/78 before extending the basic rate band; &

b) charities were able to **reclaim tax from HMRC at a rate of 22%** of the gross donation (22/78ths of the net donation).

However, the reduction in the basic rate of income tax to 20% from 6 April 2008 means that **charities should only be able to reclaim 20%** of the gross donation from HMRC (20/80ths of the net donation). This will lead to a shortfall in income for the charity.

To alleviate this, transitional provisions have been introduced such that **charities can recover an additional 2% "supplement" from HMRC** to leave them in the same position as they were before the change in tax rates. The 2% supplement will apply until April 2011.

8.5 Gifts of quoted shares and land

ITA 2007, S.431

If a taxpayer gives shares **quoted** on a recognised Stock Exchange (and the AIM) to a UK or EU, Norwegian or Icelandic registered charity, the relevant value of these shares at the date of the gift (plus any costs of transfer) is treated as a **deductible payment** in the taxpayer's income tax computation.

We deduct the relevant value of the shares (plus incidental costs of transfer) in arriving at **Net Income**. As no tax relief is obtained at source, **no other adjustment** is required in the computation. We simply deduct the relevant value from total income to give us **Net Income,** move down to **taxable** income, and calculate tax in the normal way. The basic rate **limit** will remain **unaltered**. ITA 2007, S.434

The relevant value is usually the **market value of the shares at the date of gift.** However, for disposals on or after 15 December 2009, the cost of acquisition may be substituted in certain circumstances if lower than market value. The cost of acquisition will qualify for relief instead of market value where the shares were acquired within the **four years** prior to the gift and were acquired as part of **a scheme** entered into by the individual with a purpose of obtaining an **increased amount** of tax relief.

This relief also applies to gifts of land and buildings to a registered charity. Again, the relevant value of the land and buildings (plus any costs of transfer) is a deductible payment in the donor's tax computation.

8.6 Interaction with personal allowances

There is an interaction between Gift Aid payments and the calculation of personal allowances and married couples allowance.

The personal allowance is restricted if adjusted net income exceeds the threshold of £100,000. To arrive at "adjusted net income" for the purposes of determining the Personal Allowance, an adjustment needs to be made to net income if the taxpayer has made a donation to charity.

We do this by taking normal net income - i.e. total income minus any deductible payment - and from this we **deduct** the gross donation to charity - i.e. the net amount paid by the taxpayer grossed up at 100 over 80. The resulting figure is the "adjusted net income" that is **used to calculate the personal allowance.**

	£
Actual Net Income	X
Less: donation x 100/80	(X)
Adjusted Net Income	X

Illustration 3

John has income from employment of £100,000 in 2010/11. He also receives bank interest of £10,000. He pays interest of £2,000 on a qualifying loan and makes a gift aid donation of £3,000.

In order to calculate John's personal allowance for 2010/11, we need to establish his adjusted net income.

	£
Employment income	100,000
Interest (10,000 x $\frac{100}{80}$)	12,500
	112,500
Less: deductible payment	(2,000)
Net income	110,500
Less: gross gift aid donation	
(3,000 x $\frac{100}{80}$)	(3,750)
Adjusted net income	£106,750

We can now calculate John's available personal allowance.

	£
Personal allowance	6,475
Less: reduction:	
106,750 – 100,000/2	(3,375)
	£3,100

Now we can calculate John's income tax liability as normal.

	Non Savings	*Interest*
	£	£
Employment income	100,000	
Bank interest ($10{,}000 \times \frac{100}{80}$)		12,500
Less: deductible payment	(2,000)	
Net income	98,000	12,500
Less: Personal allowance	(3,100)	
Taxable income	£94,900	£12,500

Basic rate limit	£
Original	37,400
Add: gross donation	
$3{,}000 \times \frac{100}{80}$	3,750
	£41,150

	£
41,150 @ 20%	8,230
53,750 @ 40%	21,500
94,900	
12,500 @ 40%	5,000
Tax liability	£34,730

As we saw earlier, an individual's personal age allowance will be reduced where their income exceeds £22,900. When establishing the amount of their adjusted net income for this purpose, again the gross amount of any gift aid donation will be deducted from normal net income.

Illustration 4

Basil (76) is married to Vera (68). Basil has income (non savings) of £26,000 each year. He makes a payment to charity of £1,600 each year under the Gift Aid scheme. A calculation of the allowances due is done first which then enables the tax liability to be calculated.

	£
Actual net income	26,000
Less: gross donation to charity (1,600 x 100/80)	(2,000)
Adjusted net income	24,000
PAA (> 75)	9,640
Less: ½ £(24,000 – 22,900)	(550)
PAA given	9,090
MCAA = 6,965 @ 10%	£696

	Non Savings
	£
Net Income	26,000
Less: PAA	(9,090)
Taxable income	£16,910

Tax	£
16,910 @ 20%	3,382
Less: marriage allowance	(696)
Tax liability	**£2,686**

In the computation above, no account appears to have been taken of Basil's payment to charity of £1,600. This is because Basil is a basic rate taxpayer and as a basic rate taxpayer he has already received the correct amount of income tax relief at source.

There is no point in extending the basic rate band by the gross amount of payment to the charity because Basil does not have sufficient income to use up the existing basic rate band anyway.

8.7 Carry back of Gift Aid donations

ITA 2007, s.426

The taxpayer can make an election for a gift aid donation to be treated as having been made in the previous tax year.

Therefore a Gift Aid donation made in 2010/11 could have the effect of extending the basic rate band for 2009/10.

The donation (and the corresponding election) must be made no later than 31 January in the tax year in which the gift was made. Therefore, if a 2010/11 donation is to be carried back to 2009/10, the gift and the election must be made no later than 31 January 2011.

Taxpayers making a carry-back election will gross-up the donation by the basic rate of tax which was in force for the **tax year in which the donation is treated as having been made.**

8.8 Self assessment repayments – donations to charity

Taxpayers can direct HMRC to donate their tax refunds to a charity of the taxpayers' nomination. The taxpayer indicates that the donation is to be treated as one made under Gift Aid and as a result the basic rate band will be extended by the grossed up donation in the usual way. ITA 2007, s.429

The taxpayer is able to pay either all or a specified part of the tax repayment to the charity. It is not possible to carry back the donation as it is treated as made when the charity receives it.

Example 1

Thomas (aged 62) has the following income:

	£
Salary (PAYE £5,500)	35,000
UK dividends	10,800

He makes a donation to charity of £1,500 under the Gift Aid Scheme.

Calculate his tax due for 2010/11.

Example 2

Sally (aged 45) has the following income:

	£
Salary	140,000
UK dividends	15,000

She makes a donation to charity of £2,000 under the Gift Aid Scheme.

Calculate her tax liability for 2010/11.

Example 3

Quentin (76) is married to Gwen (71). Quentin has the following income for 2010/11:

	£
Rental income	26,000
UK dividends	4,500

He made a donation to charity of £1,000.

Calculate the tax reducer in respect of Quentin's married couples allowance.

Answer 1

	Non Savings	Dividends
	£	£
Employment income	35,000	
Dividends ($\times \frac{100}{90}$)		12,000
Less: PA	(6,475)	
Taxable income	£28,525	£12,000

	£
Basic rate limit	£
Original	37,400
Add: gross donation	
$1,500 \times \frac{100}{80}$	1,875
New limit	39,275

Tax	£
28,525 @ 20%	5,705
10,750 @ 10%	1,075
39,275	
1,250 @ 32½%	406
Tax liability	7,186
Less: PAYE	(5,500)
Tax on dividends	(1,200)
Tax due	**£486**

Answer 2

	Non Savings	Dividends
	£	£
Employment income	140,000	
Dividends ($\times \frac{100}{90}$)		16,667
Less: PA (reduced to nil)	(-)	(-)
Taxable income	£140,000	£16,667

Basic rate limit	£
Original	37,400
Add: gross donation	
$2,000 \times \frac{100}{80}$	2,500
New limit	39,900

Higher rate limit	£
Original	150,000
Add: gross donation	2,500
	£152,500

Tax	£
39,900 @ 20%	7,980
100,100 @ 40%	40,040
140,000	
12,500 @ 32½%	4,062
152,500	
4,167 @ 42½%	1,771
Tax liability	£53,853

Answer 3

	£
Actual net income (26,000 + [4,500 x $\frac{100}{90}$])	31,000
Less: gross donation to charity	
1,000 x $\frac{100}{80}$	(1,250)
Adjusted net income	£29,750
PAA (>75)	9,640
Less: ½ x (29,750 – 22,900)	(3,425)
	£6,215
Cannot fall below normal PA	£6,475

Excess restriction £(3,425 – [9,640 – 6,475]) = £260

MCAA tax reducer	
£(6,965 – 260) @ 10%	**£670**