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# U.K. Charity Law: Is it Creating a True Democracy of Giving?

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# U.K. Charity Law: Is it Creating a True Democracy of Giving?


ABSTRACT

*In November 1999, the British government announced important legislative reforms affecting the various methods of providing charitable contributions. The government expressed its desire to create a "democracy of giving" by expanding tax relief for charitable donations. These changes took effect in April 2000.*

*This note argues that the recent legislation reforms, while a step in the right direction, do not create a true "democracy of giving." In arriving at this conclusion, the note will outline the evolution of British tax law related to individual charitable donations. The note will also explore the problems experienced by the charitable sector that prompted legislative reform, and will provide an overview of recent reforms in this area. An overview of the recent reforms will be provided. Finally, the note suggests that adopting U.S.-style tax relief for charitable donations would better achieve the British government's goal of creating a true "democracy of giving."*


TABLE OF CONTENTS

## I. INTRODUCTION

Approximately 300,000 charities operate in the United Kingdom.[1] These charities employ over half a million people and create roughly £12 billion[2] in economic activity.[3] Approximately one-third of the income of these charities is generated by individual donations.[4] Tax relief is available for these donations under certain circumstances.[5]

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1. HM TREASURY, REVIEW OF CHARITY TAXATION ¶ 1.1 (1999). As of September 1998 approximately 187,000 charities in England and Wales were registered with the Charity Commission. *Id.* at n.1. According to the Charity Commission, there are 80,000 to 100,000 other charities that are excepted or exempt from registration. *Id.* Such entities include churches, schools and museums. *Id.* There are also an estimated 27,000 charities in Scotland and 7,500 in Northern Ireland. *Id.*

2. As of October 19, 2000, $1 was the equivalent of £1.45. *Yahoo Finance, at* http://finance.yahoo.com/q?s=USDGBP=X&d=t (last visited Oct. 19, 2000) (on file with author).

3. *Id.*

4. Ben Griffiths, *Charities Lose Out as Donors Fail to Make Most of Tax Breaks*, Nov. 4, 1999, LEXIS, Nexis Library, ACCT. AGE File, ACCTY. AGE, Nov. 1999, at 4.

5. *Id.*

Despite the availability of tax relief for individual donations, the last two decades have shown a decline in the number of people giving to charity.[6] In response to this problem, the Government initiated a consultative process in order to draft new legislation related to charitable giving.[7] The Government announced several important legislative reforms in November 1999 intended to create a "democracy of giving."[8] These changes took effect in April 2000.[9]

This note will examine the charitable sector in the United Kingdom from the viewpoint of an individual donor. In particular, the note will analyze the primary methods of making tax-efficient gifts. The Government's consultative process will also be discussed and the legislative reforms will be outlined. Finally, this note will argue that the proposed legislative reforms do not adequately address the scope of the problem facing the charitable sector. It will be suggested that the Government adopt a U.S.-style system of income tax relief for charitable deductions in order to create a true "democracy of giving."

## II. U.K. TAX LAW RELATED TO CHARITABLE GIVING

### A. *What is a Charity?*

Under English law, a charity is a trust, corporation, or unincorporated association established for purposes (or objects) that are "exclusively charitable."[10] The preamble to the Statute of Charitable Uses 1601 (commonly referred to as the Statute of Elizabeth) listed a number of objects considered to be charitable.[11] The current leading authority on charitable purposes, *Income Tax Special Purposes Commissioners v. Pemsel*, 1891 App. Cas. 531, defines charitable purposes as (1) the relief of poverty, (2) the advancement of religion, (3) the advancement of education, and (4) other purposes beneficial to the community not falling under the previous headings.[12]

This definition does not permit what might be described as essentially "political" activities unless they are ancillary to the main

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6. HM TREASURY, *supra* note 1, at ¶ 1.7.
7. *See generally id.*
8. *See* NCVO, *Getting Britain Giving in the 21st Century* § 1, Feb. 2000, *at* http://www.ncvovol.org.uk/main/about/info/briefings/policy/giving21.pdf.
9. *Id.* at § 3.
10. C.R.J. Marlow, *Taxation of Charities: A Landlocked Regime? A Comparative Study of Selected Countries: United Kingdom*, 37 EUR. TAX. 9/10 (1997).
11. *Id.*
12. 1891 App. Cas. at 583.

objective of the charity.[13] This is not always easy to determine.[14] In *McGovern v. A-G*, the court concluded that a trust which included any of the following as its direct and principal purpose would not be charitable: (1) to procure changes in English law or the law of a foreign country; (2) to further the interests of a political party; or (3) to procure changes in government policy or administrative practice, whether in United Kingdom or abroad.[15]

English charities are registered with, and supervised by, the Charity Commission.[16] The Charity Commission is the Government department whose aim is to give the public confidence in the integrity of charity.[17] In addition to the registration and monitoring of charities, the Commission also investigates alleged wrongdoing.[18] The Charity Commission is accountable for its decisions to the courts and for its efficiency to the Home Secretary.[19] The Home Secretary appoints the five commissioners.[20] There are over 180,000 charities registered in England and Wales.[21] In 1998, the total annual income of all registered charities was close to £20 billion.[22] A significant portion of this income was derived from individual donations.[23]

### B. *Evolution of the Tax Law Related to Individual Donations*

#### 1. The U.K. Income Tax System

Since the late 1970s, a series of tax acts in the United Kingdom[24] have significantly altered the income tax system.[25] During this

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13. Marlow, *supra* note 10.
14. *Id.*
15. 3 All E.R. at 508-09. According to the Charity Commission, objects of a "campaigning" nature will not be acceptable so that, for example, a specific power to exert political pressure will not be permitted. Marlow, *supra* note 10. On the other hand, powers to present reasoned arguments and information to the Government will be acceptable as long as objectivity and balance are maintained. *Id.*
16. *About the Charity Commission*, *at* http://www.charity-commission.gov.uk/ccabout.htm (last modified July, 27, 2000) (on file with Vanderbilt Journal of Transnational Law).
17. *Id.*
18. *Id.*
19. *Id.*
20. Marlow, *supra* note 10.
21. *Facts & Figures*, *at* http://www.charity-commission.gov.uk/ccfacts.htm (last modified April 25, 2000) (on file with Vanderbilt Journal of Transnational Law).
22. *Id.*
23. Marlow, *supra* note 10.
24. For income tax purposes, the United Kingdom comprises England, Wales, Scotland, Northern Ireland, and the U.K. continental shelf. M. Roger Moore, *Taxation of Individuals in the United Kingdom*, EUR. TAX. at ¶1.1 (2000). It does not include the British Channel Islands of Guernsey and Jersey nor the Isle of Man. *Id.*

period, the income tax rate structure has been dramatically transformed.[26] The most significant reform has been the substantial reduction of income tax rates.[27] The top rate on wage income fell from eighty-three percent in the late 1970s to forty percent by 1988.[28] An additional investment income surcharge of up to fifteen percent on very high investment income, leading to a maximum income tax rate of ninety-eight percent, was eliminated in 1984.[29] The basic rate faced by most taxpayers fell from thirty-three percent in tax year 1978-79 to twenty-four percent by 1996-97, and is now twenty-two percent.[30]

The unit of taxation is the individual, although a system of joint filing for married couples was used prior to 1990.[31] More than twenty-six million individuals (out of an adult population in the United Kingdom of a little over forty million) are subject to the income tax.[32] Not all income is subject to tax.[33] The tax base includes wages, interest, dividends, some capital gains, pension benefits, unemployment benefits, royalties, property income, business income and other items.[34]

The income tax operates through a system of allowances and tax brackets. Each individual's personal allowance (the equivalent of an exemption in the United States) is deducted from total income before tax in order to determine taxable income.[35] The personal allowance is £4,385 for taxpayers under sixty-five years old in tax year 2000-01 (which ends April 2001).[36] Taxpayers over sixty-five years old are entitled to higher personal allowances.[37] After subtracting any

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25. *See generally* William G. Gale, *What Can America Learn from the British Tax System?*, 50 NAT'L TAX J. 753 (1997).

26. *Id.* The main governing legislation pertaining to the taxation of individuals in the United Kingdom is the Income and Corporation Taxes Act of 1988 and the Taxation of Chargeable Gains Act of 1992. Moore, *supra* note 24. These acts are amended every year in the annual Finance Act. *Id.* Responsibility for the administration of income tax is entrusted to the Board of Inland Revenue that is subject to the Treasury. JOHN TILEY & DAVID COLLISON, TILEY AND COLLISON'S U.K. TAX GUIDE 21 (16th ed. 1998).

27. Gale, *supra* note 25, at 756.

28. *Id.*

29. *Id.*

30. L. Chennells et al., *A Survey of the U.K. Tax System* 18 *at* http://www.ifs.org.uk/taxsystem/taxsurvey.pdf (last visited Nov. 13, 2000) (on file with the Vanderbilt Journal of Transnational Law).

31. Gale, *supra* note 25, at 762. In other words, married couples are independently responsible for their own affairs. Each spouse files his or her own return. *See id.*

32. Chennells, *supra* note 30.

33 *Id.*

34. *See generally* Gale, *supra* note 25.

35. Chennells, *supra* note 30, at 3.

36. *Id.*

37. *Id.*

personal allowances, the marginal tax rate in 2000-01 is ten percent on the first £1,520 of taxable income, twenty-two percent (the basic rate bracket) on additional income up to £28,400, and forty percent on higher levels of income.[38] It is estimated that in 1999-00 about twelve percent of taxpayers faced the lower rate, seventy-nine percent faced the basic rate, and the remaining nine percent were taxed at the higher rate.[39] Allowances and tax brackets are indexed for inflation.[40]

One of the most interesting aspects of the British income tax is that few citizens have to file tax returns.[41] Filing is usually unnecessary because withholding regulations generate (in principle) exactly the right amount of withheld taxes at source on wages and other income.[42] The main instrument of exact withholding is the "pay as you earn" (PAYE) system.[43] The PAYE system is a cumulative withholding scheme that applies to wage income.[44] Workers provide their employers certain basic information, including marital status and age, which is used to calculate withholding allowances.[45] Employers then withhold taxes as directed by these formulas.[46]

The key to exact withholding is that the process is cumulative.[47] Total tax payable for a particular financial year depends upon total income in that year.[48] Thus, when calculating tax at each paycheck, the employer considers the income not simply for the period in question, but for the whole tax year to date.[49] Therefore, employees that stop working in the middle of the year still have the correct amount withheld.[50] When an employee changes jobs, information on his or her cumulative wages and taxes is provided to the new employer, and the calculations continue.[51] In contrast, in the United States, taxes on wages are withheld, but withholding is neither cumulative nor intended to be exact.[52]

The comprehensive nature of the PAYE system has translated, in the past, to fewer than ten percent of taxpayers having to file tax

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38. *Id.*
39. *Id.* at 4.
40. *Id.* at 5.
41. Gale, *supra* note 25.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.*
46. *Id.* These formulas are referred to as "tax codes." Chennells, *supra* note 30, at 6.
47. Chennells, *supra* note 30, at 6.
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. Gale, *supra* note 25, at 758.

returns in any given year.[53] Most taxpayers filing tax returns are high-income taxpayers with asset income (taxes which have been withheld at a lower rate), those with capital gains above the exempted amount, and those with self-employment income.[54] A new system was introduced in 1996-97 that represented a move towards greater self-assessment.[55] Nine million tax returns, covering roughly twenty percent of the adult population, were issued in that first year.[56] This system presents the individual taxpayer with two options: (1) self-assessment (the deadline for filing the return and paying the tax due is the following January 31st), or (2) electing to have the Inland Revenue compute the liability based on income and expense-related information provided by the taxpayer. (The return must be filed by September 30th of each year with the tax still being due by the following January 31st.)[57]

2. History of Tax-Efficient Giving

Fiscal policy has long been a concern of the charitable sector. The issue of income tax relief for donations to charity first emerged in the early 1920s due to an unforeseen result of a provision in the Revenue Act of 1922.[58] The provision was designed to close certain loopholes that involved the use of deeds of covenant, which are "promises to pay for a specified term of years a sum of money out of an individual's income."[59] According to long-established tax law principles, such transfers could be deducted from the income of the covenantor and added to that of the covenantee.[60] The covenantee would subsequently assume any income tax liability.[61] In order to prevent excessive abuse of this technique, the Government passed legislation in 1922 denying recognition of any covenant for less than six years.[62] Covenants for longer than six years were, therefore, presumptively valid.[63]

The crucial aspect of this provision for the charitable sector was that whereas a covenant between individuals simply transferred income tax liability, a covenant between an individual and a charity eliminated income tax liability altogether.[64] Under existing law,

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53. Chennells, *supra* note 30, at 6.
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. DAVID OWENS, ENGLISH PHILANTHROPY 1660-1960, 336-37 (1964).
59. *Id.* at 337.
60. *Id.*
61. *Id.*
62. *Id.*
63. OWENS, *supra* note 58, at 337.
64. *Id.*

charitable income was not subject to tax.[65] Charities quickly recognized the potential tax benefits of deeds of covenant.[66] A seven-year covenant, therefore, entitled charitable donations to be treated as "net" amounts.[67] Using this technique, a donor who covenanted with a charity to pay a given sum annually could deduct the standard income tax. The charity could then claim the previously deducted income tax from the Inland Revenue, therefore bringing the sum received up to the gross amount covenanted.[68]

In 1927, the Inland Revenue paid out about £100,000 to charities as a result of this technique.[69] By the 1953-54 tax year, the popularity of seven-year deeds of covenant resulted in the Inland Revenue paying out £4,000,000 on almost 600,000 different claims.[70]

### 3. Pre-Reform Methods of Tax-Efficient Giving

To be tax deductible, donations must be made to recognized charities.[71] This applies to charities registered by the Charity Commission in England and Wales, and to those bodies whose charitable status has been approved by the Inland Revenue in Scotland.[72] Foreign charities are not eligible.[73]

Before the legislative reforms took effect in April 2000, there were three principal methods of making tax-efficient charitable donations: (1) deeds of covenant, (2) payroll deductions, and (3) gift aids.

#### a. Deeds of Covenant

The traditional deed of covenant is a legally binding written promise to pay a fixed sum of money each year to a specific charity.[74] Prior to the April 2000 legislative reforms, a donor was required to

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65. *Id.*
66. *Id.* Charities encouraged donors to execute seven-year covenants and would explain the procedure and provide the proper forms. *Id.*
67. *Id.*
68. *Id.*
69. OWENS, *supra* note 58, at 338.
70. *Id.*
71. Angus Gawn, *Charity Need Not be Taxing*, HERALD (Glasgow), July 31, 1999, LEXIS, Nexis Library, GHerald File.
72. *Id.*
73. *Id.*
74. Moore, *supra* note 24. Charities could sue the taxpayer if there were a failure to keep up payments. Tom Tickell, *Money-Go-Round: Chancellor Provides Cheer for Charities Budget Analysis*, DAILY TELEGRAPH (London), March 21, 1998, 1998 WL 3005305. "In theory, the Inland Revenue is entitled to ask the charity to repay the tax relief if a donor stops giving, but in practice it never does." Pauline Skypala, *It's Better to Give, Tax-Free*, DAILY MAIL, June 17, 1998, 1998 WL 13944423.

make charitable payments for at least four years.[75] In addition to being the oldest of the United Kingdom's tax-efficient methods of charitable giving, deeds of covenant have been the most popular form of planned giving.[76]

Although the deed of covenant itself was a relatively complex legal document, most charities had pre-printed forms that donors could complete and sign.[77] There was no upper limit on covenanted payments.[78] There was also no set minimum, but charities could set their own minimum to cover their administrative costs.[79] In addition to selecting an amount, a donor had to decide on the intervals at which the donations would be made.[80]

Covenanted payments provided charities with two important benefits. First of all, the fixed nature of the donation provided charities with guaranteed income and allowed them to plan ahead and budget efficiently.[81] Secondly, charities benefited by reclaiming tax from the Inland Revenue.[82] Covenanted payments qualified for income tax relief at basic and higher rates.[83] Basic rate tax relief required the donor to deduct and retain income tax at the basic rate, while the charity then reclaimed the tax so deducted.[84] For example, a donation of £10 was worth £12.20 to the charity (£10 plus basic rate income tax).[85] Tax relief at the higher rate could be claimed on the donor's Self Assessment tax return.[86] The difference between the higher rate of forty percent and the basic rate of twenty-two percent is eighteen percent. Thus, in the example above, the donor could claim higher rate relief of £2.20, which is the equivalent of eighteen percent of £12.20.

Covenants could be net or gross.[87] If a taxpayer covenanted to pay £100 gross, there would be a need to part with more tax if tax

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75. HM Treasury, *supra* note 1, at ¶ 2.5.

76. Jill Papworth, *The Taxman Can Make Your Donation Go Further if You Take Time to Plan Ahead*, GUARDIAN (London), March 13, 1993, 1993 WL 9901662.

77. David Land, *How to Make the Taxman Play Santa*, SCOTSMAN, December 13, 1998, 1998 WL 23226218.

78. Moore, *supra* note 24.

79. Skypala, *supra* note 74.

80. John Authers, *Finance & The Family; Presents for the Needy—How to... Give to Charity*, FINANCIAL Times (London), December 14, 1991, LEXIS, Nexis Library, Fintime File.

81. Papworth, *supra* note 76.

82. *Id.*

83. Marlow, *supra* note 10 (citing Section 347A TA 1988).

84. *Id.*

85. This calculation assumes the use of the tax year 2000-01 basic rate of tax.

86. Marlow, *supra* note 10.

87. Authers, *supra* note 80; *see also Giving to Charity by Individuals*, *at* http://www.inlandrevenue.gov.uk/pdfs/ir65.htm (on file with the Vanderbilt Journal of Transnational Law).

rates went down.[88] The total received by the charity would always be £100 throughout the payment period.[89] If £100 was covenanted net, then this is the sum that would always be paid by the donor.[90] The charity would receive more if tax rates rose.[91]

There were several potential problems an unwary taxpayer could encounter when entering into such an arrangement. In addition to ensuring that the correct paperwork was done before a payment was made, it was important that the taxpayer not receive a benefit from the charity as an incentive for entering into a covenant, or the donation could not qualify as charitable giving.[92] Moreover, the covenant could not be qualified with an escape clause that would enable a termination of the agreement without the charity's consent.[93] It was also necessary that the taxpayer pay sufficient income tax equal to the tax repayment that the charity would claim.[94]

If the taxpayer preferred to make a single lump donation, of say £100, which was too small to qualify for gift aid, tax relief could still be obtained by making it a loan covenant.[95] The taxpayer would execute a deed of covenant, under which the taxpayer promised to pay the charity £25 per year net for four years.[96] The balance of the donation constituted an interest-free loan to the charity, which was to be repaid in installments over the next three years to meet the annual covenant.[97]

b. Payroll Deduction Scheme

Payroll giving schemes were introduced in 1987.[98] These schemes enable employees on PAYE to make a tax-deductible gift to charity on a regular basis.[99] Employees authorize their employers to withhold donations from their gross pay.[100] The employer subsequently passes the donations onto an authorized agent who in turn pays the charity.[101] Payroll giving is open to all donors

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88. Authers, *supra* note 80.
89. *Id.*
90. *Id.*
91. *Id.*
92. *See Enriching Your Favourite Charities—With a Helping Hand from the Revenue*, HERALD (Glasgow), December 27, 1994, LEXIS, Nexis Library, GHerald File.
93. *Id.*
94. *Id.* For example, if one spouse had no income tax liability, it would be unwise for that spouse to enter into a deed of covenant. *Id.*
95. Gawn, *supra* note 71.
96. *Id.*
97. *Id.*
98. Papworth, *supra* note 76.
99. *Id.*
100. *Id.* Gross pay is the total pay before tax is deducted. *Id.*
101. Moore, *supra* note 24. The donations are usually withheld in monthly installments. Tickell, *supra* note 74.

regardless of income, provided their employers contract with an approved agency.[102]

Prior to the April 2000 legislative reforms, the maximum amount an individual taxpayer could donate using payroll giving was £100 per month or £1200 per year.[103] The maximum sum could be doubled for a couple.[104] There was no set minimum, but employers could set their own minimum to cover their administrative costs.[105] Pensioners could join their former employer's scheme, provided tax was deducted from their pension under PAYE.[106] The individual could select a preferred charity, or the gift could go to a group of charities.[107] No refund could be given once the donation was made, but the taxpayer could stop giving at any time unlike the deed of covenant.[108]

The payroll giving scheme has grown slowly since its introduction. There were only 9,000 schemes operating in the tax year 1997-98, with around 370,000 people giving £27 million.[109] In other words, less than one percent of employers operated payroll giving schemes and less than two percent of employees on PAYE participated in such programs.[110]

c. Gift Aid

Gift aid is a more recent form of income tax relief for charitable donations. This scheme was introduced in 1990 and it allows charities to reclaim the basic rate of tax on single, one-off donations.[111] There are roughly 216,000 taxpayers using gift aid.[112]

Prior to the April 2000 legislative reforms, there was no maximum amount that could be donated through gift aid, but the

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102. *See* Debbie Romney-Alexander, *Briefing Paper 1*, *at* http://www.cafonline.org/research/dimensions_payroll.cfm (last visited Nov. 11, 2000) (on file with the Vanderbilt Journal of Transnational Law).

103. Moore, *supra* note 24.

104. Land, *supra* note 77.

105. Skypala, *supra* note 74.

106. Land, *supra* note 77.

107. *Id.*

108. *Id.*

109. *See* HM TREASURY, *supra* note 1, at ¶ 2.27. Give As You Earn (GAYE), which is administered by the Charities Aid Foundation (CAF), is the largest of the agencies operating payroll deduction. Charities Aid Foundation, *The Giving Guide from CAF*, *at* http://www.givingtoday.org/downloads/givingguide.pdf (last visited on Nov. 13, 2000) (on file with Vanderbilt Journal of Transnational Law).

110. HM TREASURY, *supra* note 1, at ¶ 2.27.

111. Catherine Walker, *Briefing Paper 2*, *at* http://www.cafonline.org/research.dimensions_giftaid.cfm (last visited on Nov. 13, 2000) (on file with Vanderbilt Journal of Transnational Law).

112. Land, *supra* note 77.

minimum amount was £250.[113] To qualify for tax relief, the donation had to be recorded on an Inland Revenue certificate.[114] The purpose of the form was to create an "audit trail" for the Inland Revenue.[115] Similar to deeds of covenant, the charity was the direct beneficiary of income tax relief.[116] For example, a donation of £1000 was worth £1,220 to the charity. For higher rate taxpayers, the balance of the tax relief was obtained on the Self Assessment tax return.[117] In the example above, a donor could claim higher rate relief of £219.60 (the equivalent of eighteen percent of £1,220).[118]

d. Millennium Gift Aid

The gift aid tax relief scheme was extended to donations to certain U.K. charities operating in any of the eighty third-world countries.[119] This scheme, dubbed "millennium gift aid," was introduced in 1998 and runs until December 31, 2000.[120] This scheme affects lump-sum donations of £100 or more and smaller gifts made by monthly installments once they add up to £100 or more.[121] Donors may nominate a charity or have one selected for them at random.[122]

## III. PROBLEMS IN THE CHARITABLE SECTOR PROMPT GOVERNMENT ACTION

Recently, several disturbing trends have been identified in the charitable sector. First of all, over the past two decades, there has been a decline in the number of individuals giving to charity.[123]

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113. *Id.*
114. *Tax Tips*, BUSINESS TELEGRAPH, Sept. 8, 1999, 1999 WL 9142434.
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.* There is a structural defect under the gift aid and deed of covenant methods that only affects taxpayers that pay tax at twenty percent. Maurice Fitzpatrick, *Basic-Rate Taxpayers and gifts to Charity*, TIMES (London), Jan. 10, 1998, at 61. The Inland Revenue assumes that gifts are received net of basic rate income tax. *Id.* Thus, the Inland Revenue may charge such a charitable giver an extra twelve percent tax on the gross income that has been used for the purposes of calculating the repayment to the charity. *Id.* The IR reserves the right to charge the extra tax in order to keep their books balanced. *Id.*
119. Moore, *supra* note 24 (citing FA1998, Sec.46).
120. Gawn, *supra* note 71.
121. Jill Papworth, *The Guardian Money Page*, GUARDIAN, April 4, 1998, 1998 WL 3087505.
122. Edmund Tirbutt, *Izzard Fails to Lift Gloom Over Third World Gifts*, MAIL ON SUNDAY, October 17, 1999, 1999 WL 21945751.
123. HM TREASURY, *supra* note 1, at ¶ 1.7.

According to the Institute of Fiscal Studies (IFS), the proportion of all households giving to charity fell from over thirty-three percent in 1978 to fewer than thirty percent in 1996.[124] Although the average size of donations from donors increased in real terms from £2.24 a week per donating household to £3.65 a week, a primary cause for concern has been the dramatic decrease in the number of donations from younger households.[125] The proportion of those aged twenty to thirty-four giving to charity dropped from twenty-eight percent in 1978 to twenty-one percent in 1993.[126] Meanwhile, donations from those aged over fifty stayed fairly constant during this same period.[127] The charities fear a significant loss of income if those younger households not currently giving do not start donating to charity.[128]

### A. *Review of the Charity Taxation Consultation Document*

The Government's review of charity taxation was announced in the July 1997 budget.[129] Charities and other interested bodies were required to submit reform proposals by December 1997.[130] The Government received over 3,000 responses during the consultation process.[131] The consultation document was published on March 9, 1999.[132]

In the document, the Government stated its intention to create a new "culture of giving."[133] According to the review, the creation of such a culture requires not only offering greater incentives for donors to give to charity, but a simplification of the tax system for donors and charities as well.[134] Consequently, the review focused on four particular areas to encourage increased individual charitable donations: (1) new ideas for tax relief, (2) improving existing tax relief, (3) initiatives to promote awareness and use of the tax relief, and (4) simplification of the tax system for donors and charities.[135] In focusing on these four areas, the review analyzed the existing

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124. *Id.* The IFS is an independent research organization that provides economic analysis of public policy. *The Institute for Fiscal Studies: About IFS, at* http://www.ifs.org.uk/about/index.shtml (on file with Vanderbilt Journal of Transnational Law).

125. HM TREASURY, *supra* note 1, at ¶ 1.7.

126. *Id.* at ¶ 1.8.

127. *Id.*

128. *Id.*

129. NCVO, *supra* note 8, at § 2.

130. *Id.*

131. HM TREASURY, *supra* note 1, at ¶ 1.12.

132. NCVO, *supra* note 8, at § 2.

133. HM TREASURY, *supra* note 1, at foreword.

134. *Id.* at ¶ 1.11.

135. *Id.*

methods of tax-efficient giving available to individuals and companies and examined the direct taxes on charities and the value-added tax (VAT).[136] This note will focus only on the portions of the document related to individual contributions to charity.

1. Reforming Deeds of Covenant by Improving Gift Aid

Many responses to the Government's inquiry described the deed of covenant scheme as "complex and archaic."[137] Respondents argued that it should be unnecessary to make a legal commitment in order for the donation to receive favorable tax treatment.[138] Moreover, respondents expressed concern about the long-term commitment required under the current scheme.[139] It was suggested that this commitment deters many potential donors.[140] Another concern expressed in the document related to the difficulty of getting covenanted donors to increase their current donations, as well as to renew covenants.[141]

While recognizing the complexity of the deed of covenant scheme, the Government conceded that there was "little scope for significant further improvements."[142] The Government suggested that the best method of reforming this scheme was to improve the gift aid program.[143] Improving gift aid would hopefully make the scheme "the preferred choice of donors and charities."[144]

The Government acknowledged that the scheme, with its minimum limit for donations and the requirement of a single payment, favored high-income donors.[145] In order to make the scheme more attractive to lower income donors and the young, the Government suggested incorporating many of the additional flexibilities of the millennium gift aid program into the existing gift aid scheme when millennium gift aid expired on December 31, 2000.[146] These flexibilities include reducing the minimum limit for donations to £100[147] and allowing payments to be made in a series of smaller installments.[148]

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136. *Id.* at ¶¶ 1.14, 1.17.
137. *Id.* at ¶ 2.11.
138. *Id.*
139. HM TREASURY, *supra* note 1, at ¶ 2.11.
140. *Id.*
141. *Id.*
142. *Id.* at ¶ 2.12.
143. *Id.*
144. *Id.*
145. HM TREASURY, *supra* note 1, at ¶ 2.13.
146. *Id.* at ¶ 2.14.
147. The document suggested that the limit could actually be reduced below £100. *Id.* at ¶ 2.16.
148. *Id.* at ¶ 2.15.

According to the document, the gift aid scheme could be simplified by introducing alternatives to the current requirement that donors sign a paper certificate and return it to the charity.[149] Paperless alternatives such as filing over the Internet or the telephone were suggested.[150] In the meantime, the Government indicated that the Inland Revenue would amend the certificate so that the donor's National Insurance Number (the equivalent of a U.S. social security number) and tax office reference number need not be included.[151]

Some respondents suggested taking advantage of the Inland Revenue's contacts with taxpayers through the Self Assessment tax return.[152] They argued that these contacts could be used to remind taxpayers about the availability of tax relief through gift aid donations.[153] The Government indicated that such a reminder would be placed on future Self Assessment tax returns.[154] Some respondents also proposed a carry-back of higher rate tax relief.[155] Under such a scheme, taxpayers would have the opportunity, if they made a donation before sending in their return, to get their higher rate tax relief in the year to which the return relates.[156] The Government questioned, however, whether the complexity of such a scheme would render it impracticable.[157]

Another idea proposed by various respondents was switching higher rate tax relief from donors to charities.[158] The Government, however, disapproved of such a proposal.[159] The Government expressed concern "that it would be a serious disincentive to giving by high-income donors and would have an adverse effect on the level of giving."[160] Moreover, the Government indicated that the scheme would add complexity for donors and charities and would be difficult to operate in practice.[161]

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149. *Id.* at ¶ 2.17.
150. *Id.*
151. HM TREASURY, *supra* note 1, at ¶ 2.17.
152. *Id.* at ¶ 2.18.
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.*
157. HM TREASURY, *supra* note 1, at ¶ 2.18.
158. *Id.* at ¶ 2.19.
159. *Id.*
160. *Id.*
161. *Id.*

2. U.S.-Style Tax Relief

The Government considered U.S.-style tax relief as another possible reform.[162] In the United States, donors make gross payments to charities and claim all of the tax relief in their tax return, although the amount of the tax-effective donations that can be made in any tax year is limited to thirty percent or fifty percent of their adjusted gross income (depending on the type of donation and the type of organization to which the donations is made).[163] Adopting U.S.-style tax relief would mean that charities would be unable to reclaim the benefit of basic rate tax relief under the deed of covenant and gift aid schemes.[164] The Government noted that the payroll giving scheme is the only scheme under which all of the tax relief goes to the donor.[165]

According to the Government, the critical issue is whether moving to U.S.-style tax relief would encourage enough new giving to compensate for the corresponding drop in charities' income.[166] The Government noted that the U.S.-style system of tax relief would be impracticable since far fewer people receive an annual tax return.[167] The Government considered such tax relief a possible alternative for those who receive a Self Assessment tax return.[168] This segment of the population generally consists of the self-employed and higher-rate taxpayers.[169] The Government noted, however, that the introduction of such an option could prove overly complex.[170] Ultimately, the consultation document acknowledged the need for further research on the likely effects of a relief of this kind on donors before coming to a decision.[171]

3. Improving Payroll Giving

The review also considered reforms aimed at improving payroll giving. The review described the scheme as a "disappointment."[172] Some respondents suggested significantly increasing the maximum limit for donations.[173] The Government noted that the maximum

162. *Id.* at ¶ 2.21.
163. HM TREASURY, *supra* note 1, at ¶ 2.21.
164. *Id.*
165. *Id.*
166. *Id.* at ¶ 2.22.
167. *Id.* at ¶ 2.23.
168. *Id.*
169. HM TREASURY, *supra* note 1, at ¶ 2.23.
170. *Id.*
171. *Id.* at ¶ 2.24.
172. *Id.* at ¶ 2.27.
173. *Id.* at ¶ 2.29.

could be raised to £6,000 per annum within the existing relief framework.[174] More importantly, the Government acknowledged the possibility of removing the maximum altogether.[175] The Government indicated, however, that removing the maximum limit would require new compliance rules to prevent abuse.[176] For example, compliance rules would need to strengthen the restrictions on benefits that donors receive in return for a donation.[177]

Respondents also proposed allowing employers to distribute donations directly to charities without using an agency charity as an intermediary.[178] The respondents argued that such a system would foster closer links between workforces and their chosen charities, and that it would reduce delays in donation distribution.[179] While acknowledging the attractiveness of such a reform, the Government cited several possible issues that would need to be studied before making a final decision. First of all, the Government expressed concern that high administrative costs may discourage employers from implementing such a scheme unless they have the ability to limit employees' choices.[180] Secondly, the Government cautioned that the restrictions on employees' freedom to choose charities to support may be unacceptable.[181] Finally, the Government noted that this scheme would require employees to disclose their choice of charity to their employers, which some may not wish to do.[182]

The review also suggested mounting a publicity campaign to promote the payroll giving scheme.[183] Moreover, the document proposed a special supplement (ten percent was suggested) to charitable donations made through payroll giving for a limited period of two or three years.[184] The Government expressed hope that such a supplement would encourage more employers and charities to promote the scheme and more employees to use it.[185]

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174. *Id.* at ¶ 2.30
175. HM TREASURY, *supra* note 1, at ¶ 2.30.
176. *Id.*
177. *Id.*
178. *Id.* at ¶ 2.31.
179. *Id.*
180. *Id.* at ¶ 2.33.
181. HM TREASURY, *supra* note 1, at ¶ 2.33.
182. *Id.*
183. *Id.* at ¶ 2.36.
184. *Id.* at ¶ 2.37.
185. *Id.*

## IV. APRIL 2000 LEGISLATIVE REFORMS

The second stage of the consultation process began after publishing the review.[186] The Government encouraged interested parties to submit responses to the review.[187] The purpose of this collaboration would be to craft a legislative proposal.[188] On November 9, 1999, the Government issued a package of measures entitled *Getting Britain Giving in the 21st Century* that set out the legislative proposals.[189] Improvements to the proposed measures were announced in the Budget Statement on March 21, 2000.[190] These measures came into force on April 6, 2000, for individual taxpayers.[191]

The new measures significantly affect all three methods of tax-efficient giving. First of all, gift aid tax relief is now extended to any donation, large or small, regular or one-off.[192] The £250 minimum for one-off payments was removed.[193] This proposal goes further than the Government's earlier consultation document which suggested reducing the minimum payment to £100.[194] This reform effectively eliminates the deeds of covenant scheme. A deed will still be a legitimate method of charitable giving available to donors, but all future tax relief for payments made under a deed will be given under the new gift aid scheme.[195] Individuals are also now able to join the gift aid scheme over the telephone or the internet.[196] In order to

186. *Id.* at ¶ 1.13.

187. HM TREASURY, *supra* note 1, at ¶ 1.19.

188. *Id.* at ¶ 1.13.

189. NCVO, *supra* note 8, at § 1.

190. *Getting Britain Giving: Inland Revenue Guidance Note for Charities* § 2.1, *at* http://www.inlandrevenue.gov.uk/news/budget/charityguide.pdf (on file with Vanderbilt Journal of Transnational Law) [hereinafter *Guidance Note*].

191. NCVO, *supra* note 8, at § 3. Proposals requiring primary legislation will be included in the Finance Bill 2000. *Id.* According to the NVCO briefing, "[t]he Finance Bill is expected to receive Royal Assent by August, although its provisions will be backdated to April 2000." *Id.* In addition, the NCVO reports that "other proposals will be implemented over the spring/summer in secondary legislation." *Id.*

192. Sarah Tanner, *Pre-Budget Report: Review of Charity Taxation, at* http://www.ifs.org.uk/charities/pbr_gaye.pdf.

193. *Id.*

194. *Id.*

195. *Getting Britain Giving: What Charities Need to Know about the Government's New Charity Tax Measures, at* http://www.ncvo-vol.org.uk/main/about/info/briefings/policy/TaxReview_WhatNeedToKnow.pdf (on file with Vanderbilt Journal of Transnational Law) [hereinafter *What Charities Need to Know*]. Donations made under Deed executed on or after April 6, 2000, must be covered by a Gift Aid declaration. *Id.*

196. *Id.*

reclaim tax on donations, however, charities must send the donor a written record of the declaration.[197]

The payroll giving scheme was also amended. The £1200 maximum on annual donations through the scheme was eliminated.[198] Employees are now able to donate as much as they like through payroll giving. In addition, the Government launched a publicity campaign to promote the scheme.[199] As a part of this campaign, the Government will pay a ten percent supplement on top of all payroll giving donations for three years.[200]

The Government also created a new form of tax relief on donations of certain shares and securities. Individuals are now able to get tax relief for gifts of certain shares and securities to charity when calculating their income for tax purposes.[201] This new tax relief will be available in addition to the existing relief for gifts of shares, securities, and other assets to charity when calculating capital gains.[202] Donors can deduct (1) the market value of the shares or securities at the date of disposal; plus (2) any incidental costs of disposing of the shares, including broker's fees; less (3) any consideration given in return for disposing of the shares; and (4) the value of any other benefits received by the donor, or a person connected with the donor, in consequence of disposing of the shares.[203] Donors will claim the tax relief, at their top rate of tax, on their Self Assessment tax return.[204]

### A. *The Impact of These Changes*

The immediate impact of these measures on individual donations to charity is unclear. Although official Government estimates are unavailable, the Government has expressed hope that the total package of reforms will be worth about £1 billion to charities.[205] Naturally, the Government believes that the measures will boost the number of donors, as well as the size of contributions.[206] Is the Government's belief justified?

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197. *Id.*
198. *Id.*
199. *Id.*
200. *Id.*
201. *Guidance Note*, *supra* note 190, at §10.1
202. *Id.*
203. *Id.* at §10.4.
204. *Id.* at §10.5.
205. NCVO, *supra* note 8, at § 4.1.
206. *Id.*

1. The Impact on Gift Aid and Deeds of Covenant

The National Council for Voluntary Organizations (NCVO) recently published a study of the impact of the legislative proposals on the charitable sector.[207] In their study, the NCVO singled out the new gift aid scheme as the most significant aspect of the legislation.[208] According to the NCVO, the success of the new gift aid scheme will depend on two critical factors: (1) "[T]he degree to which tax efficiency acts as an incentive to donors to give to charity in the first place, or indeed to give more to charity (the incentive effect)," and (2) "[T]he extent to which current methods of giving are amenable to tax relief under the new schemes or put another way, how much current giving can be 'converted' to tax-efficient giving (*i.e.* the conversion rate)."[209] Maximizing both the incentive effect and conversion rate could lead to gains to charity as high as £350 million per year.[210] The NCVO admits, however, that the gains to charity could be as low as £70 million per year if there is no incentive effect and there are low rates of conversion to tax efficiency.[211]

One of the factors that will affect the success of the new gift aid scheme will be the extent to which the new legislative measures simplify tax-efficient giving.[212] Several features of the legislation will undoubtedly simplify the current system. First of all, the options for tax-efficient giving will be clearer since the new gift aid scheme effectively renders deeds of covenant obsolete.[213] Although they will remain legally valid, deeds of covenant will no longer be valid for tax purposes.[214] The donor will need to complete a gift aid declaration form in order to make a tax-efficient gift.[215]

The second simplifying feature of the legislation relates to gift aid declaration forms. Currently, donors are required to complete a paper declaration form.[216] The donor then must return the form to the charity in order to reclaim the tax benefit.[217] Under the new gift aid scheme, donors will be able to sign up for the gift aid scheme over

207. *Id.* The NCVO is the umbrella body for the voluntary sector in England. *NCVO and the Voluntary Sector*, *at* http://www.ncvo-vol.org.uk/main/about/does/volsec.html (on file with Vanderbilt Journal of Transnational Law). It is a lobbying and research organization. *Id.*

208. NCVO, *supra* note 8, at § 4.1.

209. *Id.*

210. *Id.* at § 4.3.

211. *Id.*

212. *Id.*

213. *Id.*

214. NCVO, *supra* note 8, at n.6.

215. *Id.*

216. *What Charities Need to Know*, *supra* note 195.

217. *Id.*

the telephone or the internet. (The traditional paper declaration form will still be an option.)[218] This added flexibility will certainly improve the current dismal level of tax-efficient giving.

The most important simplification may be the removal of the £250 minimum for donations through gift aid. The NCVO believes this reform has the potential to revolutionize tax-efficient giving to charities.[219] They cite evidence that "many more people give small amounts of money than large amounts."[220] The NCVO indicates that this reform brings the Government closer to its objective of creating a "democracy of giving."[221]

Simply removing the minimum threshold for tax-efficient giving, however, does not mean that charities will reclaim a tax benefit on gifts of any size. There is still a considerable administrative burden on charities.[222] The onus is still on charities to process completed declaration forms in order to reclaim tax benefits from the Inland Revenue.[223] Increasing numbers of donations will only increase this burden. As a result, charities will likely institute their own cost-effective minimum.[224] Where the minimum is set will probably depend on the "size, resources and experience" of the various charities.[225] Larger charities will be better equipped to handle the influx of donations while keeping costs low.[226] Medium and smaller-sized charities, on the other hand, may not be able to achieve the same economies of scale.[227] The NCVO expresses hope that these smaller charities will somehow be able to band together in order to keep costs low.[228] Regardless, it seems fairly certain that there will be some discrepancy between charities as to minimum thresholds for tax-efficient giving under the new gift aid scheme. Thus, the new scheme will not be as simple to administer as the Government suggests.

There is still a question whether the new gift aid scheme will encourage increased donations. The history of the millennium gift aid scheme is telling. Under millennium gift aid, the minimum threshold was set at £100.[229] Although the lower threshold and

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218. *Id.* NCVO, *supra* note 8, at § 4.3.
219. NCVO, *supra* note 8, at § 4.3.
220. *Id.*
221. *Id.*
222. *Id.*
223. *Id.*
224. *Id.*
225. NCVO, *supra* note 8, at § 4.2.
226. *Id.*
227. *Id.* ("For charities not able to make use of this scheme the benefit available to them will be significantly less—and maybe not enough to compensate them for the loss of ACT credits.")
228. *Id.* at § 5.
229. *Id.* at § 4.3.

additional flexibilities were effective in persuading existing contributors to take advantage of tax-efficient giving, the program has not brought in new donors.[230] The Government originally estimated that charities would reclaim £25 million in tax.[231] As of October 1999, charities had only recovered £500,000.[232] One of the reasons cited for this disappointing performance is the administrative burden: charities cannot claim basic rate income tax relief until donors complete declaration forms.[233] Concern has also been expressed that people may give less since tax relief can be obtained on a smaller amount.[234]

2. The Impact on Payroll Giving

The impact of the current reforms on individual donations is unclear with respect to payroll giving. The Inland Revenue estimates that the total cost of the three year ten percent supplement on gifts made through this scheme will be £17 million.[235] This estimate assumes that the number of payroll givers will double over the three-year period.[236] While the Government's assumptions may be impressive, it is important to note that there are relatively few payroll givers in the program. Only one percent of employers and two percent of employees currently participate in the scheme.[237] The NCVO, however, is optimistic about the outlook for the program. They note that "[twenty-one percent] of the general population whose employers did not currently offer a payroll giving scheme said that they would or might join if it was offered."[238] Achieving greater employer participation in the plan is, therefore, critical to long-term success. Currently, primarily large employers use the program.[239] The under-representation of small and medium-sized employers could limit the effectiveness of the program.[240] The NCVO indicates that it is unclear how simple and accessible the scheme is for these smaller employers.[241] The Inland Revenue will address this issue by publishing guidance for employers on the most effective way of operating a payroll-giving scheme.[242]

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230. Tirbutt, *supra* note 122.
231. *Millennium Gift Aid Plan Fails to Make Mark*, DAILY EXPRESS, Oct. 6, 1999, at 1999 WL 25395490.
232. *Id.*
233. *Id.*
234. *Id.*
235. NCVO, *supra* note 8, at § 4.4.
236. *Id.*
237. *Id.*
238. *Id.*
239. *Id.*
240. *Id.*
241. NCVO, *supra* note 8, at § 4.4.
242. *Id.*

One of the criticisms leveled at the ten percent supplement on charitable donations has been that it adds another level of complexity to the scheme.[243] The legislation appeared to be moving towards greater simplicity and equality.[244] Rather than foster a "democracy of giving," the supplement favors one type of donor over another: those not on PAYE, including the self-employed and most pensioners, are excluded from participating in the scheme.[245] The new legislation does not explain the reason for this favoritism.

The Government's second important reform of the payroll giving scheme is the removal of the £1200 per annum ceiling on donations. Will this reform increase donations to charity? The answer is unclear. Currently, only one percent of payroll donors gives donations at the £1200 limit.[246] The NCVO hopes that removing the ceiling will encourage high net worth individuals to increase the size of their current donations or even begin to give through the program.[247] According to the NCVO, the £1200 ceiling gave the scheme a "blue-collar image."[248] The NCVO's research reveals that seventy-three percent of higher payroll givers would be likely to increase their payroll donations if the limit was lifted or abolished.[249] Their research also reveals, however, that eighty-nine percent of lower payroll givers would not change their level of giving.[250]

The NCVO admits that abolishing the ceiling may not be necessary in order to encourage greater participation in the program.[251] The NCVO, relying on evidence suggesting that workers would give more if prompted, notes that "[a]gencies and employers need to be encouraged to ask their payroll donors if they wish to increase their donations on a regular basis."[252] There is a fine line, however, between promoting the scheme and inappropriately pressuring employees to contribute greater sums of money to charity. Therefore, it is important that agencies and employers err on the side of promotion.

3. Donations of Shares and Securities

It remains to be seen whether the new tax relief available on donations of shares and securities will increase the amount of

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243. Tanner, *supra* note 192.
244. *Id.*
245. *Id.*
246. NCVO, *supra* note 8, at § 4.4.
247. *Id.*
248. *Id.*
249. *Id.*
250. *Id.*
251. *Id.*
252. *Id.*

charitable giving. According to the NCVO, it is particularly difficult to predict the impact of this scheme because there are no readily available statistics with regard to pre-reform levels of share and security donation.[253] Nevertheless, the NCVO concludes that this reform, which targets high net worth individuals, has the potential to be a valuable form of giving.[254]

This reform represents a major departure from the concept of making the charity itself the direct beneficiary of the tax relief, and creates an incentive for a potentially powerful type of charitable giving.[255] For example, someone earning £100,000 a year could donate £50,000 worth of shares to charity. The donor would pay income tax on only £50,000 of income because of the donation. This would save roughly £20,000 in taxes. Someone earning £50,000 and giving £50,000 in shares would pay no income tax.

4. The Cost to Charities of Implementing Legislative Proposals

The cost to charities of implementing the legislative proposals is unclear. The NCVO identifies three important variables affecting cost: (1) the flexibility and adaptability of charities, (2) how easily existing systems can adapt to the new schemes, and (3) how far existing practices can incorporate such new schemes.[256] In addition to these generalizations, charities will be presented with several concrete problems as a result of this legislation. First of all, it is almost certain that this legislation will result in a greater number of donations.[257] The removal of the minimum threshold in the new gift aid scheme, in particular, will contribute to this problem.[258] As discussed above, charities will need to set their own minimum threshold in order to cover costs.[259] Larger charities will undoubtedly be able to set a lower threshold than medium and smaller sized charities.[260] Larger charities may also be better equipped to maintain relationships with the influx of new donors.[261] Thus, it appears that costs to the sector will depend heavily on the size of the charity.

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253. NCVO, *supra* note 8, at § 4.5
254. *Id.*
255. C. Duncan Rice, *Culture of Giving: Britain's Boost for Charity*, WALL ST. J. EUR., Apr. 7, 2000, at 10.
256 NCVO, *supra* note 8, at § 5.
257. *Id.*
258. *Id.*
259. *Id.*
260. *Id.*
261. *Id.*

## V. WILL THE LEGISLATIVE CHANGES INCREASE CHARITABLE GIVING?

### A. *Is Tax Relief the Best Method of Benefiting Charity?*

The most fundamental criticism of the new legislative measures concerns the importance of tax relief for charitable donations.[262] Unfortunately, tax relief is not a "free lunch" for charities.[263] The opportunity cost may most clearly seen as the Government giving up tax revenue which it could pass on to charities as grants.[264] The issue is whether tax relief is the best method of benefiting charity.

The Government based its legislative reforms on the assumption that expanding tax relief will increase the number and size of individual donations to charity.[265] The IFS notes that the possible danger to this assumption is that individuals will donate less to charity.[266] Eliminating the minimum threshold for tax-efficient giving under the new gift aid scheme, for example, could lead to smaller contributions.[267]

While the possibility of *decreased* individual giving is unlikely, the millennium gift aid experiment, and payroll giving to a lesser extent, both demonstrate the Government's overly optimistic outlook on this issue.[268] Millennium gift aid has been roundly panned as a flop[269] while the Government itself acknowledged in its consultation document that payroll giving had been a "disappointment."[270] Rather than phasing out the current millennium gift aid scheme, the Government decided to *expand* the scheme by removing the minimum threshold entirely and introducing other added flexibilities.

While stretching the current tax relief system to its breaking point, the Government ignored one possible reform that could possibly lead to an even greater increase in individual charitable giving. In its consultation document, the Government briefly considered U.S.-style tax relief.[271] The proposal was quickly dismissed out of administrative concerns.[272] The Government

262. NCVO, *supra* note 8, at § 5.
263. James Banks & Sarah Tanner, *Taxing Charitable Giving*, *at* http://www.ifs.org.uk/charities/giving.shtml.
264. *Id.*
265. *Id.*
266. *Id.*
267. *Id.*
268. *Id.*
269. Tributt, *supra* note 122.
270. *Id.*
271. *Id.*
272. *Id.*

thought it impracticable to consider U.S.-style relief when the majority of U.K. taxpayers do not even file tax returns.[273] In so hastily dismissing this possibility, however, the Government may have overlooked an exciting reform.

### B. *The United Kingdom Should Introduce U.S.-Style Tax Relief for Charitable Donations*

In reforming the tax law related to charitable giving, the Government recognized the importance of tax incentives in fueling increased charitable donations.[274] Certain changes to the tax law reflect a departure from the traditional notion that charities should be the direct beneficiaries of tax relief. For example, tax relief on donation of shares and securities creates an incentive by making the *donor* the direct beneficiary of the tax relief.

This form of tax relief, however, has limited appeal because only those taxpayers who can afford to donate shares and securities can take advantage of this relief. Thus, this form of relief will generally only be available to high net worth givers. Most taxpayers will be faced with the option of either donating to charity under payroll giving or through gift aid. Unfortunately, there are limitations to each program.

An important flaw in the payroll giving scheme is the exclusion of those not on PAYE. This exclusion is significant because donors under payroll giving have their donations subtracted from their gross income. Thus, charitable donations reduce their income tax liability. Those not on PAYE must resort to donating through gift aid. Gift aid, however, does not offer the same tax advantage. The charity reclaims the basic rate tax under this scheme. This inequality runs contrary to the Government's intention of creating a "democracy of giving." Moreover, this inequality is exacerbated in the short term by the Government's three year ten percent supplement on donations made through payroll giving.

While not creating any unequal treatment problems like payroll giving, the new gift aid scheme still contains certain complexities. First of all, gift aid still requires pro-active steps: the donor must still complete a gift aid declaration form in order for the charity to reclaim basic income tax relief (although now the donor will be able to complete the form over the phone or the internet). Secondly, charities will most likely not be able to seek relief on donations of any size. Each charity will need to establish a minimum threshold in order to cover costs. While not presenting a serious challenge to donors, this variation will foster at least some uncertainty. Thirdly, and perhaps

273. *Id.*
274. *Id.* Government sees this as a way to achieve a "giving age." *Id.*

most importantly, there is still relatively little incentive for the donor to make gifts under this scheme. This incentive problem could be addressed if the Government was willing to consider U.S.-style tax relief.

How might the U.S.-style regime work in the United Kingdom? The U.S. and U.K. systems are similar in that, through tax relief, they lower the "cost" of giving to the individual donor, even if their way of doing this is very different. Under the U.S. system, a donor paying tax at a theoretical rate of thirty-five percent, who makes a charitable gift of the U.S. equivalent of £1000, gets a net saving of £350. The gift thus costs £650. Under the U.K. system, a donor paying tax, again at a theoretical rate of thirty-five percent, who makes a gift to a registered charity of £650, gives the charity the opportunity to reclaim tax of £350. The charity thus ends up with £1000. In both systems the donor "spends" £650 for the charity to receive £1000. The U.K. system, however, requires the donor to take positive steps to make the gift tax effective: the donor must complete the declaration form. With the U.S. system, the gift is automatically tax effective: it is only the tax situation of the donor that can limit his or her ability to use the tax deduction. It can be argued that the U.S. system is particularly effective in encouraging the donor to give because receiving a tax deduction "feels" like a real incentive.

The Government considered U.S.-style tax relief as a possible reform in its consultation document.[275] Adopting U.S.-style tax relief would mean that charities would be unable to reclaim the benefit of basic rate tax relief under the deed of covenant and gift aid schemes.[276] This would need to be compensated for by an increase in the amounts given by a greater number of donors attracted by the relief and encouraged to give more.

The climate for charitable giving in the United States suggests that the loss of charitable income from reclaimed basic rate tax would be compensated for by increased donations. A quick comparison of the state of charitable giving in the United States versus that in the United Kingdom reveals a substantial philanthropy gap: ninety-five percent of U.S. households make charitable contributions compared to only thirty percent of U.K. households.[277] In addition, cash donations to charities amount to nearly two percent of U.S. gross national product compared to only 0.7 percent in the United Kingdom.[278]

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275. HM TREASURY, *supra* note 1, at ¶ 2.21.

276. *Id.*

277. John Quelch & William Conner, *Cost of Giving; John Quelch and William Conner Want to See U.K. Tax Laws Brought into Line With the US, Where People Give Much More Because Its Cheaper*, GUARDIAN (London), Sept. 8, 1999, at 41.

278. *Id.*

The British system may be nobler, but for that very same reason it may also be less effective. One commentator has pointed out: "As any good student of human nature knows, true altruism is extremely rare. But mix it with a little bit of self-interest and the chance to knock yourself down a tax bracket and you'd be amazed how generous the human soul can become."[279] The question then becomes whether such a system of tax relief is viable under U.K. charity law.

In the consultation document, the Government noted that the U.S.-style system of tax relief would be impracticable since far fewer people receive an annual tax return.[280] The Government considered such tax relief as a possible alternative for those who receive a Self Assessment tax return.[281] The Government worried, however, that the introduction of such an option could prove overly complex.[282]

A U.S.-style relief is more likely to be used by older and richer donors rather than the younger and lower paid people from whom the Government is keen to seek more donations, because U.K. tax returns are usually only completed by the self-employed and higher rate taxpayers. For these older and richer taxpayers there would be the incentive of tax relief over and above the "feel good factor" of having given. In practice, the lure of that relief may outweigh any complications in claiming it.

Thus, it appears that U.S.-style tax relief could be practicable in the United Kingdom in a limited context. This scheme would certainly remedy the inequality faced by the self-employed, who are excluded from participating in payroll giving. There would obviously be a concern about providing too much favorable tax treatment to the wealthy. Experimenting with this style of income tax relief on a limited basis, however, may prove worthwhile in case the proposed reforms do not reverse the trend towards decreased individual giving in the United Kingdom.

## VI. CONCLUSION

With the legislative reform of the tax laws related to charitable giving, the Government is moving in small, crab-like steps, albeit in the right direction. There is certainly cause to worry, however, that these reforms come "too little, too late." The charitable sector is at a crossroads with regard to individual donations. While the rate of charitable contributions from older taxpayers has remained steady in recent years, statistics show that donations from younger people are

279. *Id.*
280. HM TREASURY, *supra* note 1, at ¶ 2.23.
281. *Id.*
282. *Id.*

in decline. In addressing this problem, the Government has demonstrated a willingness to experiment with different charitable giving schemes. Rather than revolutionize charitable giving, however, the United Kingdom opted to rely on the same system that is arguably the root of the problem. The current tax regime not only requires a thorough understanding of the various forms of charitable giving but also of the various tax benefits associated with those forms of giving. In addition, the form of tax relief available to donors depends heavily on economic and occupational status. Thus, it is perplexing that in its effort to create a "democracy of giving," the United Kingdom refuses to experiment with U.S.-style tax relief. In recent years, the U.K. income tax system has moved towards greater self-assessment. This new system signifies a shift in the responsibilities of individual taxpayers, who are now expected to calculate the tax owed and to remember to pay on the appropriate dates. U.S.-style tax relief is readily adaptable to this system of self-assessment. By combining greater self-assessment with U.S.-style tax relief, the United Kingdom could move one step closer to creating a true "democracy of giving" in which all donors enjoy relief from income tax liability regardless of occupational or economic status.

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