SAUNDERSON
HOUSE

Gifting to charity tax efficiently

July 2018

Income Tax and Capital Gains Tax Relief

Lifetime gifts to charity are important to many of our clients. Often gifts are made in cash, which normally enables the charity to reclaim gift aid, and higher and additional rate taxpayers to receive income tax relief, thereby benefitting both parties. However, many are unaware of the option of gifting investments instead (including quoted shares, unit trusts and open-ended investment companies or OEICs), which can achieve greater tax savings, as explained below.

How It Works

If the charity is able to accept qualifying investments, these can be transferred to the charity for them to sell themselves (neither the transfer to the charity or the subsequent disposal by the charity are subject to CGT). While the charity cannot claim gift aid on gifted investments, the donor can claim income tax relief on the full amount at their marginal rate.

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Case Study

Joe Smith is an additional rate taxpayer earning c£750,000 pa. He has significant surplus earnings such that he is able to make a substantial charitable donation of £100,000.

Alongside his pensions and ISAs, Joe has accumulated a sizeable taxable portfolio over many years and as part of the usual investment management of his portfolio, due to strong investment growth, he crystallises gains in excess of his Capital Gains Tax (CGT) exemption each tax year. Given his earned income, the excess gains over his CGT exemption are subject to tax at 20%.

We recommended switching a fund (an OEIC) worth c£100,000 (with an unrealised capital gain of c£40,000) within his taxable portfolio into a preferred alternative. Given Joe had already utilised his CGT exemption this tax year, the gain crystallised on disposal would have resulted in a CGT liability of £8,000 (20% x £40,000).

When Joe mentioned that he wished to make a substantial charitable donation, we explained the tax benefit of gifting the fund to his chosen charity, instead of making the payment out of surplus cash, as shown below. Joe could then invest the £100,000 of cash into the portfolio, and replace the gifted fund.

	Gifting cash (£)	Gifting investments (£)
Value of assets gifted	100,000	100,000
Gift aid – reclaimed by charity	25,000	-
Gift value to charity	**125,000**	**100,000**
Income tax relief received by Joe	31,250[1]	45,000[2]
Capital gains tax relief	-	8,000
Tax saving for Joe	**31,250**	**53,000**
Net cost of gift to Joe	**68,750**	**47,000**

[1] Additional rate income tax payers can claim the difference between the rate they pay (45%) and the basic rate (20%) on the grossed up value of the donation (£125,000). Therefore Joe could receive 25% income tax relief on £125,000.
[2] Joe's income tax can be reduced by 45% of the value of the gift (£100,000).

The net cost of the donation to Joe is £21,750 lower (though in this case the charity would not receive the £25,000 gift aid). If Joe wished for the charity to still receive the same amount (£125,000), the net cost (using the same proportions) would still be £10,000 lower, as detailed overleaf with an amended case study.

Amended Case Study – Charity Receives The Same Amount in Each Case

The fund is worth £125,000 and, given strong investment growth since purchase, has an unrealised capital gain of £50,000. Given Joe has already utilised his CGT exemption this tax year, the gain crystallised on disposal would result in a CGT liability of £10,000 (20% x £50,000).

Joe gifts the fund to his chosen charity, instead of making the payment out of surplus cash, and then invests the £100,000 of cash into the portfolio, to largely replace the gifted fund.

	Gifting cash (£)	Gifting investments (£)
Value of assets gifted	100,000	125,000
Gift aid – reclaimed by charity	25,000	-
Gift value to charity	**125,000**	**125,000**
Income tax relief received by Joe	31,250	56,250
Capital gains tax relief	-	10,000
Tax saving for Joe	**31,250**	**66,250**
Net cost of gift	**68,750**	**58,750**

Point to Note

Note that not all charities are able to accept investments, but in such cases, the charity can request that the donor disposes of the fund and then donate the proceeds (as cash) to the charity. In this case, the disposal will not be subject to CGT, though HMRC may need a clear paper trail of the request for disposal and subsequent cash donation (which is relatively simple in practice).

Separately, if Joe intends to retire in the near future (and he is unlikely to remain an additional rate income tax payer in retirement), and was intending to continue to make regular gifts to charity in retirement, he could potentially make a sizeable contribution to a charity account. He could then make donations to charities over time. Crucially, the tax relief is applied in the year that the shares or cash are transferred to the charity account (i.e. at outset). Therefore, even if the distributions to charities are made in future tax years when Joe has a much lower income, he would have received the full benefit of the tax relief on the gift in the tax year it was made.

Conclusion

If you are considering making meaningful gifts to charity, or have any questions related to tax-efficient giving strategies, do contact your usual Saunderson House adviser.

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