

## Making the Most of Gift Aid

Gift aid provisions are one of the most effective ways for charities to make valuable incoming resources go even further. They are often commonly misunderstood and underutilised.

This helpsheet examines a number of aspects of the various gift aid provisions and considers:

- ***how charities that are trading using a non-charitable company should ensure that they stay the right side of the provisions; and***
- ***how charities that receive gifts in cash from individuals should ensure that they reclaim gift aid correctly, and how to avoid the potential pitfalls of a visit from HMRC.***

Surprisingly for many readers, we are going to start with gift aid for trading companies as this area is often misunderstood.

### Charities and trading - gift aid for companies

Charities that trade in excess of the deminimis levels (currently a maximum of £50,000) will usually do so by way of a non-charitable trading subsidiary. This trading subsidiary company can generate profits which can be surrendered in the form of tax deductible gift aid payments to a qualifying UK charity (by way of a charge against income).

#### ***'Wholly owned' subsidiaries***

Generally, such tax relief from gift aid donations is ***available only in the accounting period of the trading company during which the payment of the donation is made***, but there are some special rules for companies that are 'wholly owned' by charities. The definition of a ***'wholly owned' trading company*** for the purposes of the gift aid regulations warrants further investigation.

Many charities assume that the trading company should be set up as a company limited by guarantee (i.e. having no share capital). This assumption is often based on an understanding that the ***company limited by guarantee*** is the appropriate model for the not-for-profit sector. While this is the case for charitable companies themselves, it is not necessarily the case for the trading company, for which the ***company limited by share capital*** model may often be a better option.

The reasons are as follows. As we have identified above, qualifying gift aid payments only qualify for tax relief in the period in which the payment is made unless the payment is made to the charity which 'wholly owns' the trading subsidiary. This can be particularly problematic when using a trading subsidiary specifically for 'profit shedding' purposes as the ***amount of profit available is unlikely to be known at the exact date of the year end*** – an estimate would have to be used. Payments to charities which wholly own its subsidiary on the other hand may be made up to 9 months after the end of the accounting period in which relief is claimed, allowing plenty of time to calculate and 'shed profits precisely'.

For these purposes, **a charity wholly owns a subsidiary** when either:

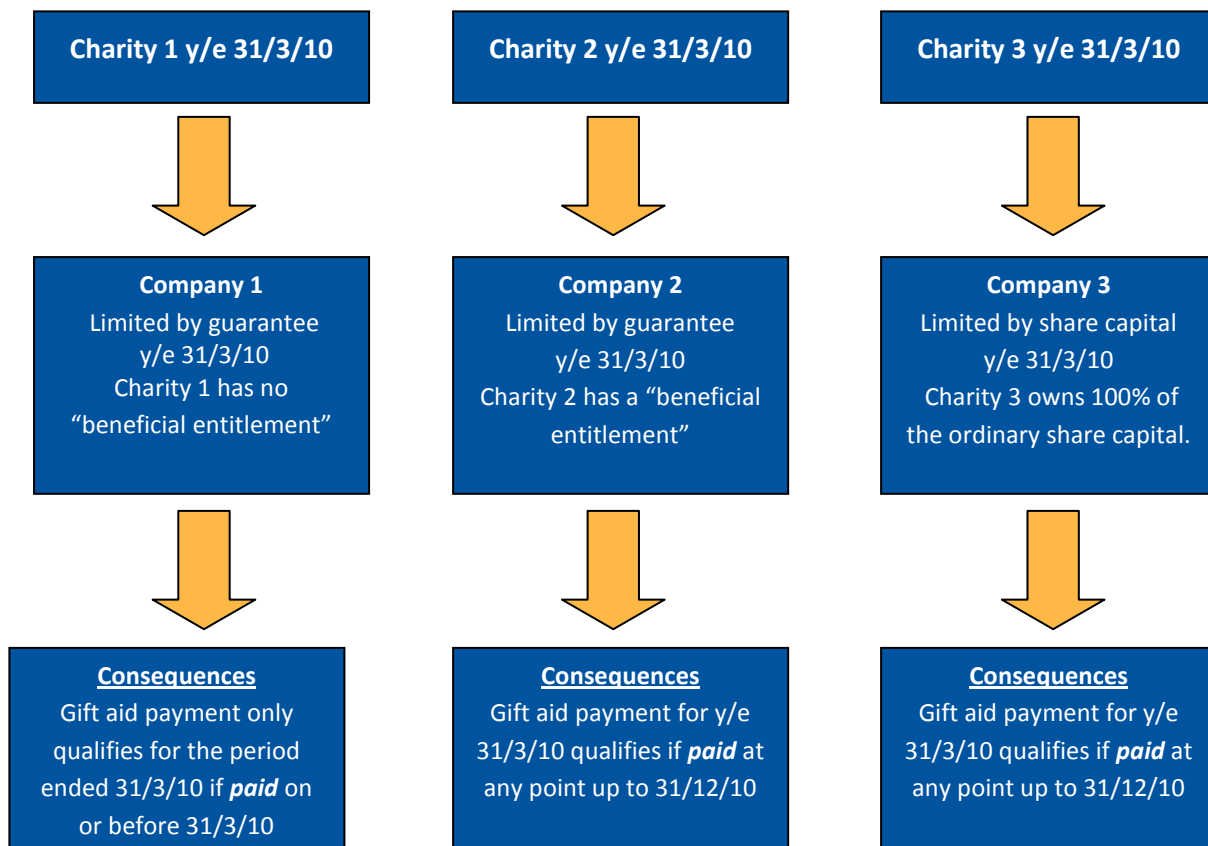
- a) it owns **100% of the ordinary share capital** of the subsidiary company; or
- b) it is **beneficially entitled to participate** in its profits or to share in its net assets in the event of a winding up.

**‘Beneficial entitlement’**

It is with respect to b) above that many charities risk falling foul of the rules relating to qualifying payments. The memorandum and articles of the trading subsidiary will usually not provide for any beneficial interest on behalf of the controlling charity. For example, the memorandum of a company limited by guarantee will usually dictate that in the event of a winding up, any residual assets may be distributed to another organisation having similar aims and objectives at the discretion of the directors.

Amending the memorandum to give beneficial entitlement to the Charity would thus mean that the trading company now falls within the definition of ‘wholly owned.’ This could be done simply by stating in the memorandum that in the event of winding up that all residual assets would be paid to the charity.

*The following may help to illustrate the issue:*



## Gift Aid for donations

Gift Aid is a very effective way for charities or CASCs (community amateur sports clubs) to **increase the income generated from monetary gifts** that they receive from individuals paying tax in the UK. It works by allowing the charity to effectively **reclaim the basic rate income tax** that has been suffered by the individual before they made their gift out of taxed income – the charity effectively ‘grosses up’ the payment for the income tax.

For example (lets ignore NI and any other deductions for a moment), if I pay basic rate tax on my income and I earn, say, £15,000 per year, for each additional £1,000 of income I earn I receive £800 after tax (£1,000 less tax of 20%). If I make an £800 donation to a registered charity, then I am giving away £800 of my post tax income. The gift aid rules allow the charity to reclaim that £200 of tax that I have suffered on that income. If I made a £1,000 post tax donation, then the charity would be able to reclaim £250 from the revenue (being £1,250 less 20% tax).

Before we continue there are two key points to consider at this stage. Firstly, the above examples apply only to a basic rate of tax of 20% - the amounts reclaimed would need to reflect the prevailing rate of basic rate tax at the time the donation was made. Secondly, there are also tax advantages to the higher rate tax payer who can claim back the difference between higher rate and basic rate tax suffered on the donation (this will not be considered further within this helpsheet).

### Qualifying donations

The rules governing qualifying donations were relatively straightforward – gift aid can only be claimed on **gifts of ‘money’ from UK taxpaying individuals**. So essentially the monetary donation will qualify if made in the form of:

- cash, cheque, credit card, debit card or telegraphic transfer;
- direct debit or standing order; or
- postal order.

The situation appears slightly more complex however for **charities trading in donated goods**. HMRC have recently accepted the argument that when an individual donates used goods (clothing, books etc) to a charity shop, they are donating one kind of asset (stock) that the charity (usually through a shop) converts into another kind of asset – cash. HMRC therefore accepts that it may be appropriate in certain circumstances for charities to recover the gift aid. It is important to note however that the same basic principle applies – that **the charity can only recover the gift aid on the donation of the monetary asset (in this case cash generated from sales)**. This is achieved by the charity effectively acting as agent for the donor- the donor agrees that charity will sell the goods on their behalf and then when cash is generated, the donor gifts that cash to the charity. It is only when the cash is gifted can the charity reclaim the gift aid.

It is important to recognise that there are a **number of types of donation that do not qualify** for recovery of income tax under these rules, the main ones being:

- gifts of monetary assets from a company and donations in the form of a loan waiver or debt conversion;
- gifts made on behalf of other people – for example the payment by a third party of some costs relating to charity staff members;
- any gifts to which repayment terms attach or with enforceable conditions about how the money should be used; and
- payments for which any goods or services are received in return or for which a ‘minimum donation’ is stipulated – subject to the comments below regarding benefits received in return for donations.

***Providing benefits in return for donations – important warnings***

We have noted above that ***where goods or services are provided in return for donations then these payments will not qualify***. HMRC does allow however, that ***subject to certain conditions, a charity may give donors modest (low value) ‘tokens of appreciation’*** while allowing the payments to qualify, subject to the following limits (for gifts from 6 April 2007):

| Amount of donation | Limit on value of benefit |
|--------------------|---------------------------|
| 0 – £100           | 25% of the donation       |
| £101 – £1,000      | £25                       |
| More than £1,000   | 5% of the donation        |
| More than £10,000  | £500                      |

Many charities will wish to exercise care in respect of these limits when conducting charity auctions. At these auctions, as the bidder usually receives something of value in return for their payment, the payment is technically not a gift, and ‘gift-aid’ applies only to gifts.

Fortunately, HMRC acknowledges that the nature of these auctions dictates that individuals will be prepared to pay more for an item than its actual ‘value’ and will allow gift aid reclaims subject to the rules on benefit values not being breached. ***Care should be exercised when assessing an item’s ‘value’ for these purposes.*** Where an item is commercially available, the ordinary commercial price of that item is its value. Where an item is not commercially available, then its value is likely to be deemed to be the value of the successful bid.

Another reason to be very careful in respect of these situations is that the benefit values above apply only to gift aid. ***For VAT purposes, the ‘value’ will be irrelevant.*** The reason for this is that for

VAT purposes, a donation is a voluntary payment for which no benefit is given in return – and ***donations are outside the scope of VAT.***

If anything at all is received in return for the payment, then for VAT purposes the charity is making a 'sale' and the whole payment is likely to be subject to VAT. The main exception to this is the sale by a charity of donated goods (but beware – not services!) which are zero-rated for VAT purposes.

## **Reclaiming gift aid**

Anyone with experience of reclaiming gift aid will know that the current system can be laborious, largely because for most it is a paper-based system. Recent surveys suggest that ***1 in 4 charities are failing to make claims where valid entitlement exists.*** There are numerous reasons for this ranging from the amount of work perceived in retaining data and making claims, to fear and ignorance as a result of the relative complexity of the rules. Although a campaign is currently underway to promote awareness and to simplify the procedures, for now we are stuck with the present arrangements – and here's what you have to do to reclaim gift aid 'in a nutshell':

### ***Recognition as a charity by HMRC***

Many charities assume that their recognition as a registered charity with the Charity Commission gives them automatic entitlement to charitable tax benefits. This is not the case. ***Each charity or CASC has to be recognised by HMRC as a charity*** – the first step towards this will usually be registering with the Commission, but you will also need to submit form 'CHA1' to HMRC for them to officially recognise your charity as such for tax purposes. Longer established charities may also wish to ensure that they have registered their charitable status with HMRC.

### ***Nomination of an authorised claimant and/or nominee***

Before making a claim, you must notify HMRC of your authorised claimant and/or nominee – the person who can sign claims and/or receive money on the charity's behalf. This might be an employee, trustee, accountancy firm, or any other person/organisation that you consider appropriate.

### ***Complete and submit your 'R68 schedules' and then the 'R68 claim form'***

The 'schedules' disclose details of all of the individuals who have completed a gift aid declaration form and how much they have paid. You will need to keep appropriate paper trail/other evidence of this to allow a link between each individual claim and the declaration made in support of it. Note that for the purposes of filling in the claim form, ***you can aggregate small donations of less than £10*** on one line (subject to a maximum aggregation of £500) but you must still keep an audit trail.

Once you have aggregated and completed all of your schedules, you then use this information to complete the claim form, remembering to provide precise details in respect of the method of repayment.

### ***Maintain an audit trail***

The basic requirement is that in respect of any tax reclaim, ***HMRC must be satisfied that for each entry, the donation and the individual satisfied the qualification criteria*** discussed in detail above.

Remember that as a minimum, for each gift you should retain details of:

- the name and address of the individual;
- the precise amount donated; and
- a signed statement to confirm that the individual was a UK tax-payer during the relevant accounting period.

Each collection of cash must be attributed either singly or in aggregate to a schedule of gift aid declarations. This means that in practice you should retain documentation that is cross-checked for compliance by individuals who are independent of the process and that totals collected should be cross-checked against individual ***declarations that should be retained for a period of 6 years*** from the time that amount is included in a gift aid claim. A record should be kept of how the cash was collected and how it was banked.

### ***Timescales***

***Claims must be made within 4 years*** of the end of the accounting period to which the claim relates.

## Office locations and contact details

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4. **Business details**

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