Response to HMRC Consultation on
“A new incentive for charitable legacies: A lower rate of inheritance tax when leaving 10% of an estate to charity”

Charities Aid Foundation (CAF)
Charity Finance Directors’ Group (CFDG)
National Council for Voluntary Organisations (NCVO)

August 2011

This is a joint consultation response by The Charities Aid Foundation, The National Council for Voluntary Organisations and the Charity Finance Directors’ Group. These are three organisations with distinct policy voices, but a shared viewpoint on this issue.
The Respondents

**Charities Aid Foundation (CAF)**
CAF is a registered charity that helps charities and social enterprises make the most of their money. CAF provides financial, investment and fundraising services and works directly with tens of thousands of charitable organisations across the UK and internationally. We also provide services and support to thousands of individual donors, enabling them to give tax-effectively to charitable organisations across the UK and around the world. Our knowledge and understanding - gained through direct experience and research - makes us a trusted voice on giving and the effective use of charitable funds.

**Charity Finance Directors’ Group (CFDG)**
CFDG is the charity that supports charities in their finance-related functions, promoting best practice in charity finance, driving efficiency and helping organisations to make the most out of their money. CFDG’s circa 1,700 members – all senior financial professionals in the voluntary sector – are responsible for managing around £17.53 billion in charity funding. Our members work at the heart of the strategic development of their organisations, and are at the forefront of delivering a sustainable and efficient charity sector.

**National Council for Voluntary Organisations (NCVO)**
NCVO is the largest general membership body for voluntary and community organisations (VCOs) in England. Established in 1919, NCVO represents over 8400 organisations, from large ‘household name’ charities to small groups involved in all areas of voluntary and community action at a local level. NCVO champions voluntary action. Our vision is of a society in which people are inspired to make a positive difference within their communities. A vibrant voluntary and community sector (VCS) deserves a strong voice and the best support. NCVO works to provide that voice and support.
Background

1.1 In the current economic climate, many charities are finding themselves caught between greater demand for their services and reduction in public sector funding. It is crucial, therefore, to find new sources of non-statutory income.

1.2 Charitable donations are the most important source of income for charities.\(^1\) However, evidence shows that donation levels in the UK have remained fairly static for a number of years,\(^2\) so expecting a step-change in charitable giving driven solely by greater levels of fundraising is not necessarily realistic. New methods of giving and incentives for doing so could play an important role in encouraging more people to give and people to give more. Therefore the proposed measure to reduce the rate of inheritance tax (IHT) from 40% to 36% for those leaving 10% or more of their estate to charity is a welcome one.

Establishing a new norm:

2.1 One of the stated aims of introducing the new IHT measure is to “establish a new norm” around leaving 10 per cent of one’s estate to charity.\(^3\) This seems to be in line with the Government’s interest in the “nudge theory” of behavioural economics: designing the “choice architecture” of a system to increase the likelihood of people making what is seen as the most desirable choice.

2.2 If the establishment of a new norm is an explicit aim, then this must be taken into account when assessing whether or not the incentive has been successful. The consultation does give projections for the take-up of the new incentive and for the increase in income to the voluntary sector. However, as noted, any predictions about the number of estates where the amount left to charity is increased as a result of the new IHT relief are highly speculative. Hence it is difficult to know how useful these projections are as a baseline against which to measure.

2.3 Aside from the specific norm of leaving 10 per cent of one’s estate to charity, it is possible that the new IHT relief might have some impact in encouraging people to think about charitable bequests in residual rather than pecuniary terms (i.e. as a percentage of the final value of their estate, rather than as a specific amount fixed at the time of making their will). This would be a positive development for charities, as the value of pecuniary legacies decreases over time due to inflation, whereas the value of residual legacies does not.

\(^1\) NCVO, *Civil Society Almanac 2010*

\(^2\) CAF/NCVO, *UK Giving 2010*

\(^3\) Chancellor of the Exchequer’s Budget 2011 Statement

[www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110323/debtext/110323-0001.htm#11032368000001](http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110323/debtext/110323-0001.htm#11032368000001)
Limitations of the new measure

3.1 Currently less than half of people who die leave a will. In 2008/09, there were approximately 575,000 deaths, and only 272,000 estates notified for probate (representing 47%).

3.2 The number of estates liable for IHT is small. HMRC’s own figures highlight the fact that in 2008/09, only 6 per cent of estates (15,439 out of a total of 256,846 estates notified for probate) were liable for IHT payments after exemptions had been applied. Hence only 2.7 per cent of UK deaths in 2008/09 resulted in any tax being paid.

3.3 In the Giving White Paper, the Government stated its desire to “encourage more people to give more generously and to persuade those who do not give to start.” However, the new relief on IHT is only likely to have an impact on the amount given by existing donors, rather than encouraging more people to donate. It is explicit in the consultation that “leaving a charitable legacy under the new rules will still result in an overall cost to the beneficiaries compared to not leaving anything at all to charity in a will.” Hence there is no reason for anyone not thinking of leaving a charitable bequest to consider doing so as a result of the new rules, so the new measure will only act as an incentive for those already planning on leaving a charitable legacy to leave more.

3.4 Currently only 16 per cent of estates contain a charitable bequest. Given the proportion of people who die intestate, this means that only around 7 per cent of people leave a charitable gift in their will. It is not clear what percentage of those estates that contain a charitable bequest also pass the IHT threshold. This makes it difficult to estimate the potential impact of a reduction in IHT rate as an incentive for charitable giving. However, there is evidence that larger estates are more likely to contain a charitable bequest (for instance 41.2 per cent of estates of £1m or more do). This suggests that an IHT incentive may have some impact, as those estates for which a reduction in tax would be relevant are more likely to be ones in which charitable giving is being considered.

3.5 There is already an issue with lack of awareness/understanding of legacy giving. In order for the new incentive to have the maximum possible impact, charities and advisers will have to promote it effectively to suitable donors. There is a

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5 Ibid.
6 Ibid.
8 Atkinson, Backus & Micklewright, Charitable Bequests and Wealth at Death in Great Britain, University of Southampton, 2009
10 Atkinson, Backus & Micklewright, Charitable Bequests and Wealth at Death in Great Britain, University of Southampton, 2009
clear opportunity here to “sell” the measure to those considering making a charitable bequest on the basis that it costs the same to make a 10 per cent legacy donation under the new rules as it does to make a 4 per cent one (see figure 1). However, many charities- particularly smaller ones who often struggle to understand the intricacies of tax-effective giving- are wary of giving what might be seen as financial advice to donors.

Scope of the new measure
4.1 All assets should be included within the 10% test. This would ensure that charities achieve maximum benefit from the measure. Although this may, in some instances, result in an increased administrative burden from valuing the assets, the potential benefits to charities should outweigh the cost.

4.2 As the measures proposed are quite complex, we believe that the related guidance will be important. We welcome HMRC’s commitment to providing this guidance and consider that it should be used to provide greater clarity and confidence to charities and donors about how to promote and use this measure and about which assets would be considered eligible within the 10% test. The guidance could also be helpful in providing examples of appropriate wording for standard will clauses.

4.3 The question of potential avoidance should be viewed in the context of the limitations outlined above. As highlighted, the new measure will apply only to a relatively small number of estates of sufficient size where charitable giving is already considered. Hence the potential for new forms of avoidance is limited.

Broader implications for charitable giving
5.1 This new incentive must be seen as one of an array of measures aimed at fostering a culture of giving in the UK, and not viewed in isolation as an end in itself.

5.2 In particular, it would be a concern if the introduction of this new incentive for charitable gifts upon death undermined the longer-term aim of encouraging lifetime giving. A broad range of individuals and organisations (including CAF) have been proposing for some time that the government should consider the case for introducing Lifetime Legacies in the UK, to mirror the availability of Charitable Remainder Trusts in the US. The fact that a new incentive on IHT has been announced should not be seen as a reason not to engage with the Lifetime Legacy agenda. Despite the apparent similarity suggested by the fact that they are both concerned with “legacy gifts”, they are in fact quite different proposals that would meet different needs.

12 http://www.civilsociety.co.uk/fundraising/news/content/794/caf_and_treasury_to_pursue_lifetime_legacies
Figure 1: Example of a donor leaving £1m in a will under the new rules

The assumed formula for total value of residue X under these rules is:

\[ X = R + C \cdot (E - (R + G)) \]

\[ \text{Where } R \text{ is the value of the nil rate band (currently £325K); } E \text{ is the gross value of the estate, } G \text{ is the value of the charitable gift and } C \text{ represents the appropriate rate of IHT).} \]

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<thead>
<tr>
<th>Percentage of net estate given as charitable legacy</th>
<th>Residue of estate (£)</th>
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<tbody>
<tr>
<td>0</td>
<td>730,000</td>
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<td>4</td>
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\[ \text{This example assumes that there are no IHT exemptions other than the charitable bequest.} \]