

Philanthropy and charitable giving: A new incentive for charitable legacies

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What has happened?

The Chancellor's March 2011 Budget announced that a reduced rate of inheritance tax (IHT) would be introduced for those who donate 10% or more of their net estate to charity. HM Revenue and Customs has today released a consultation paper setting out additional detail on this proposal and seeking public response to a series of questions.

What is proposed?

For deaths on or after 6 April 2012, it is now proposed that an individual who includes charitable legacies in his will of at least 10% of his net taxable estate will benefit from a 36% rate of IHT, a 10% reduction from the usual IHT rate of 40%.

The purpose of this relief is to incentivise giving generally, but it will be particularly incentivising for those people who were already considering leaving legacies who may find under the proposed relief that they can leave more to charity without taking away from the amount left to their non-charitable beneficiaries.

How does it work?

Who needs to receive the legacy?

In order to qualify for the proposed relief, the legacy will need to be left to an organisation that is a charity for UK tax purposes, that is, an organisation established in the UK, a European Union Member State, Iceland or Norway that would be a charity under the law of England and Wales (if it were located in England or Wales), is registered with a charities regulator (if required in its local jurisdiction) and is managed by fit and proper persons. It will also be possible to leave eligible legacies settled in trust for exclusively charitable purposes or to a Community Amateur Sports Club.

How much does the legacy need to be?

Under the proposals, the reduced rate will apply if the total amount of charitable legacies is more than 10% of an individual's taxable estate after deducting the amount of the nil rate band (currently £325,000) and the value of any exempt property (e.g. property passing to a surviving spouse or civil partner). So, for example, after the rule changes, an unmarried individual with a total estate of £850,000 and single unused nil rate band of £325,000 will have a taxable estate of £525,000 and will need to leave 10% of that amount (£52,500) to charity to qualify for the IHT reduction. In this example, his taxable beneficiaries would then receive an estate after tax of £627,400. This compares with £640,000 after tax if no charitable legacy were included.

What is to be included in the calculation of the 10% threshold (for example will it be just those assets that pass by the will, or should it extend to jointly held property) is one of the matters on which responses have been invited in the consultation. Also being consulted on is the assets to which the reduced rate should apply.

What is the cost of this legacy?

In the example above, after the IHT reduction, the £52,500 'cost' of the charitable legacy is split between the Treasury, which receives £39,900 less in tax and the beneficiaries, who receive £12,600 less from the estate (compared to the position had no charitable legacies been included).

Who will benefit?

Clearly the main beneficiaries of this measure will be charities who will receive greater levels of legacies. However, where this proposed relief is most interesting is for those who were already planning to leave a significant legacy to charity.

So using the same example above, if our individual had already proposed to leave a legacy to charity that amounted to 4% of his taxable estate (£21,000) this would leave £627,400 after tax for his taxable beneficiaries.

With the IHT reduction under the proposed rules, the same value of after-tax estate is achieved with a 10% legacy to charity. With this in mind, in

some circumstances an existing charitable legacy can be increased at no cost to the taxable beneficiaries.

Further, whenever the existing legacy is more than 4% but less than 10% there will be a net saving to the taxable beneficiaries if the charitable legacies are increased to 10%. Continuing with our example estate, leaving charitable legacies totalling 5% (£26,250) will result in an after-tax estate of £624,250. By increasing the charitable legacies to 10%, the after-tax estate rises to £627,400.

For any person who has written or is proposing to write a will leaving charitable legacies totalling more than 4% but less than 10% of their taxable estate, this new relief will potentially give a considerable boost to the amount they can leave to charity, without disadvantaging their other beneficiaries. This should be a great incentive for increased charitable giving.

What about lifetime giving?

This measure should clearly encourage the 'tithing' of estates on death and in the long term increase the overall level of charitable donations. However, many charities face funding shortfalls now and a long term measure such as this will do little to address current funding concerns. Similar initiatives are needed to encourage lifetime giving, for example the introduction of lifetime legacies, which allow a donor to make a deferred but irrevocable gift to charity during his or her life, but receive income on it for life or a set term.

What happens next?

Responses are being sought on a number of targeted consultation questions and the consultation will formally close on 31 August 2011. The outcome of this consultation should feed into draft legislation that will be published for further consultation before Budget 2012 and will be included in the 2012 Finance Bill.

What should I do now?

All individuals should consider revisiting their wills to see if they wish to take advantage of the reduction in the rate of inheritance tax charged on their estates. For those who already have legacies of between 4% and 10% of their taxable estate included in their wills, there is a compelling reason to increase the level of their giving.

Charities will want to ensure that they are fully informed about the new regime and may wish to update their legacy fundraising materials to reflect it, once finalised. In the meantime, charities may expect queries from potential donors. Some charities may wish to respond to the HMRC consultation directly, in particular around the consultation questions concerning non-monetary gifts.

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