National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

Gift Aid and reliefs on donations

HC 733 SESSION 2013-14 21 NOVEMBER 2013

Key facts

£2bn	£217m	£170m
cost to Exchequer of tax reliefs on donations provided to charities, individuals and companies in 2012-13	tax at risk from marketed avoidance schemes on claims dating from 2004 onwards	HMRC's rough estimate of tax lost through abuse of the reliefs, 2012-13

Where the reliefs go

£1 billion	the value of Gift Aid relief HMRC paid to charities in 2012-13, about 2 per cent of all charity income
£940 million	tax relief provided to individuals and businesses on their donations to charity in 2012-13

HMRC's administration of the reliefs

1,800	open avoidance cases relating to marketed schemes that use the reliefs
£63 million	of loss HMRC prevented from examinations of the reliefs provided to charities in 2012-13, up from £15 million in 2009-10
£9.7 million	the cost of administering Gift Aid and other reliefs for charities, 2012-13
£44	the amount of tax that HMRC's charities team estimates that it recovered for every £1 of direct spend on compliance work in 2012-13

Summary

The context for this report

1 The government collects taxes to fund public services, and help individuals, households and businesses with targeted financial support. Government can use the taxation system to redistribute wealth and influence behaviour. It must also keep the tax system competitive to protect tax revenue and support economic growth.

2 All tax systems include tax reliefs, which are rules intended to reduce an individual's, charity's or company's tax liability. HM Treasury is responsible for strategic oversight of the tax system. HM Treasury and HM Revenue & Customs (HMRC) work together in a policy partnership on the development of tax policy, including the design of tax reliefs. HMRC administers the tax system, and is responsible for the maintenance of tax policy, providing advice on the design of tax rules and monitoring their application.

3 There is no official categorisation of different forms of tax relief, but in its published statistics HMRC identifies relief on the income of charities as one of a subset of tax reliefs it calls 'tax expenditures'. Tax expenditures include a broad range of reliefs, described by HMRC as reliefs "to help or encourage particular types of individuals, activities or products. Such reliefs are often an alternative to public expenditure, and have similar effects". HMRC has incomplete data on the costs of these reliefs but identifies 47 principal tax expenditures, which range in value from £50 million a year for the smallest to £20 billion for the largest.

4 As government's auditors we would reasonably expect to see evidence of an effective system of controls to design, manage and evaluate the use of a tax expenditure which is rigorous and proportionate, and would share many of the features that we would expect for a spending programme. For example: an adequate evidence base is available to support decisions over design of the relief or changes to it, including lessons learnt from evaluations of other reliefs; there is clarity about how government intends to monitor and assess the cost and impact of the relief and evaluate its outcomes; and, adequate safeguards are in place to prevent excessive leakage through abuse and error.

5 This report examines whether the way Gift Aid and other reliefs on donations to charity are administered by HMRC and evaluated by the exchequer departments meet these criteria. We have examined Gift Aid and tax reliefs on donations in particular following the Committee of Public Accounts' (the Committee) concern about the potential scale of abuse of reliefs on donations to charity. In June 2013, the Committee concluded that the Cup Trust charity was part of a tax avoidance scheme which put over £46 million of tax at risk through claims for Gift Aid relief.[1] We are reporting separately on the questions the Cup Trust raised about the Charity Commission's effectiveness as a regulator of charities.

How Gift Aid and reliefs on donations work

6 Successive governments have legislated to exclude charities from income tax, including income from donations, since the first permanent Income Tax Act of 1842. Gift Aid reflects this principle and is one of the largest tax reliefs available to charities. It provides an important source of income to charities, representing around 2 per cent of total charities' income.

7 When individuals make a donation, the charity may ask them to complete a Gift Aid declaration, authorising the charity to claim Gift Aid. The donor needs to be a UK taxpayer and to have paid enough income tax or capital gains tax to cover the amount the charity will reclaim on the donation. The charity claims a repayment from HMRC of the basic rate tax that the donor is deemed to have paid on the sum donated. If the donor is a higher or additional rate taxpayer, the donor can also claim relief on the difference between their highest tax rate and the basic rate (**Figure 1**).

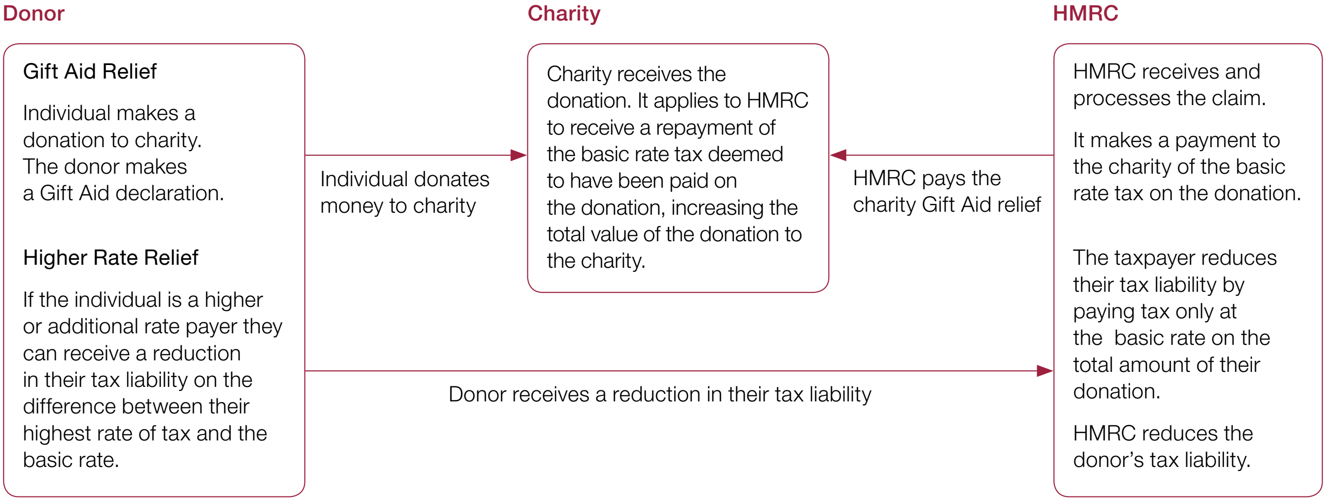
8 There are also reliefs available to individuals and companies when they donate certain shares and other qualifying investments to a charity (hereafter referred to as Gift of Shares and Securities) and to companies when they donate money. Charities do not receive a repayment from HMRC on these donations; instead the reliefs reduce the donor's taxable income by the value of the donation. The four reliefs on donations covered by our report are shown in **Figure 2**.

9 It is important that tax reliefs on donations are well administered to protect the reputation of the charitable sector and give confidence to donors. In common with many other tax reliefs, reliefs on donations are susceptible to abuse and error. HMRC runs checks to manage losses from such abuse and to act as a deterrent. HMRC has a dedicated charities team which is responsible for coordinating HMRC's work on the tax affairs of charities.

1 HC Committee of Public Accounts, *Charity Commission: the Cup Trust and tax avoidance*, Seventh Report of Session 2013-14, HC 138, June 2013.

Figure 1
Gift Aid relief provides a repayment of tax to charities

Higher rate taxpayers can also receive a reduction in their tax liability



Source: National Audit Office review of HM Revenue & Customs guidance

Figure 2
Main reliefs on donations to charity and recipients

Relief	Description	Recipient of relief	Example
Gift Aid relief	A gift of money to a charity from an individual who pays UK tax. The charity can reclaim the basic rate of tax paid on the donation.	The charity	On a £100 donation the charity can reclaim £25. The total value of the donation to the charity is £125.
Higher Rate relief	Higher rate and additional rate taxpayers can reclaim the difference between their highest rate of tax and the basic rate on donations made under Gift Aid.	Higher rate taxpayers	On a £100 donation a higher rate taxpayer can reclaim £25. An additional rate taxpayer can reclaim £31.25.
Corporate Gift Aid	A gift of money to charity. Companies can reduce their taxable income by the amount donated.	Companies	A company donates £100 to charity and reduces its taxable income by the same amount.
Gift of Shares and Securities	Individuals or companies donating shares and securities can reduce their taxable income by the value of the gift.	Mostly affluent individuals and companies	An individual donates £100 of shares to charity and reduces their taxable income by the same amount.

Source: HM Revenue & Customs guidance on giving to charities

10 The main risks of the reliefs being applied in a way Parliament did not intend are:

- **Fraud.** Criminals may falsify donations to generate a repayment of Gift Aid relief. They may set up a charity to facilitate the fraud, hijack the details of a charity, or use a position of influence in an existing charity.
- **Avoidance activity.** Companies and individuals may create ways to avoid tax particular to their circumstances. Avoidance schemes may also be marketed by promoters on the basis that they provide the scheme user with a potential tax benefit that is greater than the true value of the donation. Other schemes operate by extracting the value of the donations from the charity.
- **Error.** For example, charities may mistakenly submit incorrect details or duplicate claims or claim relief when the donor did not authorise Gift Aid. Individuals may also sign a Gift Aid declaration when they have not paid enough tax for their donation to qualify.

The scope of this report

11 This report examines:

- the costs and effectiveness of Gift Aid and reliefs on donations in meeting their objectives (Part One); and,
- HMRC's response to the abuse of the reliefs (Part Two).

Our audit approach and evidence base are summarised at Appendices One and Two.

Key findings

Objectives, costs and effectiveness

12 Gift Aid is an important source of income for charities, having largely displaced other reliefs on donations paid to charities by HMRC. Charities identify Gift Aid as an essential fundraising tool. As the value of Gift Aid payments has increased, it has as intended largely displaced other forms of relief, such as that previously available on covenants. In real terms, the amount paid to charities in respect of reliefs on donations increased between 1990 and 1999 but fell following changes made to Gift Aid in April 2000 which extended the range of the reliefs and redirected some relief from the charity to the donor. The amounts paid to charities have since risen to over £1 billion a year, similar in real terms to their value in the late 1990s before these changes took effect (paragraphs 1.4 to 1.10).

13 **The government has multiple objectives for reliefs on donations.** Tax relief on donations reflects a long-held principle, consistently accepted by Parliament, that charitable income should be exempt from taxation where that income is used for charitable purposes. Gift Aid and other reliefs on donations are current mechanisms for achieving this. They encompass a wider set of objectives, such as making the taxation system simpler for charities and donors to use and encouraging more giving by making donations more tax efficient (paragraphs 1.4 to 1.6).

14 **Since Gift Aid was reformed in 2000, there has been a significant increase in the costs of reliefs claimed by donors, but HMRC does not know if the changes have met the objective to encourage more charitable giving.** Adjusted for inflation, charities received £1,060 million in tax relief on donations in 1999-2000, and donors received £130 million; in 2012-13, charities received £1,040 million, and donors around £940 million. The changes in 2000 broadened access to tax efficient giving and made the tax system simpler for charities and donors to use, supporting the broad principle of exempting charitable income from taxation. When the changes were made, however, the exchequer departments did not establish a framework, or set out to collect data, by which they could have evaluated their wider effects. HMRC has since undertaken research on the impact of the changes, but the evidence they had collected was not robust enough to provide assurance that the incentives have met the objective to encourage more people to give more to charity. Research from the charitable sector is inconclusive about how patterns of giving have changed, but there is no evidence of a causal link between the changes to the reliefs and the value of donations (paragraphs 1.11 to 1.17).

15 **Government has not set out what good performance would be.** The broad objectives of the reliefs to widen access and simplify the tax system could be met even if HMRC's performance in administering them was poor. For example, though it has commissioned research to understand the barriers to take-up, HMRC has not identified what level of take-up of Gift Aid should be achievable. A rise in the uptake of Gift Aid among donors by ten percentage points could result in charities receiving an additional £94 million in relief. This would involve changing the behaviour of some 2.5 million donors (paragraphs 1.4 to 1.6 and 1.18 to 1.19).

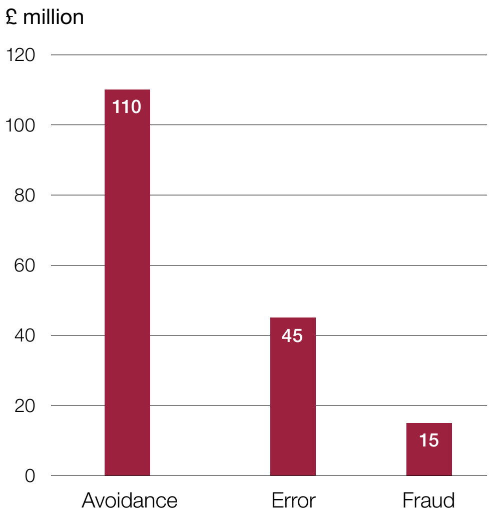
16 **HMRC does not have an accurate estimate of how much tax is lost through avoidance, fraud and error in respect of reliefs on donations.** HMRC has produced a working estimate that £170 million was lost in 2012-13 based on its analysis of tax loss in related areas. However, it recognises that its methodology is crude and may understate the level of loss. For example, donors need to have paid tax in order for charities to reclaim payments of Gift Aid. Our analysis suggests that HMRC may be paying a further £55 million in error where the donor has paid insufficient tax to allow the charity to claim Gift Aid. HMRC plans to undertake a full analysis of the losses in respect of reliefs on donations in autumn 2013 (paragraphs 1.24 to 1.25).

HMRC's response to abuse of the reliefs

17 **HMRC faces a serious compliance challenge in respect of reliefs on donations, in particular from avoidance.** Our analysis of HMRC's estimate of losses in 2012-13, shows that the largest losses occurred through avoidance activities such as, for example, the misuse of Higher Rate relief (**Figure 3** and paragraphs 1.24 to 1.25).

Figure 3
Estimate of losses in 2012-13

Avoidance accounts for the largest losses from tax reliefs on charitable donations



Note

1 The figures are after any activities HMRC has taken to reduce losses. The figures exclude tax at risk through marketed avoidance schemes as HMRC does not expect any of these claims to succeed. HMRC does not categorise its losses as 'avoidance', 'error' or 'fraud'. The split is based on National Audit Office analysis of the recorded figures.

Source: National Audit Office analysis of HM Revenue & Customs data

18 **Significant sums are at risk from marketed avoidance schemes, though HMRC is confident it can counter this threat.** HMRC has identified eight marketed avoidance schemes that fall into three broad categories, estimating that they put £240 million of tax at risk. Following its investigations, 200 users have since withdrawn claims to the value of £23 million. There remain 1,800 open cases, representing approximately 5 per cent of all avoidance cases HMRC is investigating across the tax system and about 2 per cent of the value. HMRC is challenging these claims and does not expect any to succeed when heard at tribunal so therefore does not estimate any tax loss will result from the claims (paragraphs 2.9 and 2.40).

19 **It is more difficult for HMRC to detect and counter the avoidance activities of individuals or companies that do not rely on marketed schemes.** Those charities that are used as vehicles for tax avoidance are generally unfamiliar to most people and do not receive donations from the general public. While a very small proportion of charities are set up to abuse charitable status, the cumulative costs of small-scale avoidance activity are large, accounting for £110 million of tax lost in 2012-13 (paragraphs 2.7 to 2.8 and 2.33).

20 **HMRC estimates that compliance work by its charities team prevented the loss of £63 million of tax at risk from the abuse of reliefs on donations in 2012-13, a four-fold increase since 2009-10.** Before 2009, HMRC's emphasis had been on quickly processing Gift Aid claims so that charities received the repayments quickly, and few security checks were undertaken. Recognising the risks that this posed, it introduced a new strategy in 2009 to tackle fraud, strengthened its manual checks on repayments, and introduced controls to reduce mistakes and better identify fraudulent claims (paragraphs 2.24 to 2.27 and 2.44).

21 **In 2012-13, HMRC prevented £44 of tax loss for every £1 spent on staff checking Gift Aid claims and charities' tax affairs for compliance, but does not know if it has the optimal level of resourcing.** A doubling of compliance staff since 2009-10 has increased this ratio from 21:1 to 44:1, which compares favourably with HMRC's rule of thumb that investment in compliance work should provide a marginal return of around 11:1. HMRC's charities team is considering revisions to its staffing model to increase the impact of its work (paragraph 2.45 to 2.48).

22 **Acting on HMRC's advice, the government has made changes to tax law which have helped to prevent the abuse of reliefs.** HMRC recommended changes, which government introduced, to stop the exploitation of reliefs on donations following the identification of specific tax avoidance schemes in 2004 and 2009. It believes these changes have prevented additional people from using the schemes while deterring attempts to establish new schemes. Government introduced legislation in 2010 to allow HMRC to apply a 'fit and proper persons' test to the managers of charities, giving it the power to refuse claims for tax reliefs and exemptions from existing charities. On each of the around 200 occasions it has raised questions in relation to this test, the application has been withdrawn (paragraphs 2.14 to 2.15 and 2.31 to 2.32).

23 **HMRC does not combine all the information it holds about the operation of reliefs on donations, and so lacks a complete picture of the nature of the risks and the cost and impact of its interventions to counter them.** While the HMRC's charities team is responsible for the risks relating to the tax affairs of charities and processes Gift Aid claims, claims for relief on donations by individuals and businesses are processed by other parts of HMRC's business. The charities team does not have oversight of these checks and other teams in HMRC are not required to pass on information about relevant investigations or the impact or cost of their interventions. HMRC's information on the losses it has stopped is therefore incomplete. In 2012-13, it identified that it had stopped £15 million in fraudulent Gift Aid claims by charities and £31 million on claims by charities containing or made in error. However, it did not collect data on how much avoidance or error it stopped relating to individuals claiming Higher Rate relief or companies claiming Corporate Gift Aid (paragraphs 1.21, 2.16 to 2.19 and 2.44 to 2.46).

24 **There remain gaps in HMRC's knowledge about its charity customers that prevent it from tailoring its interventions most effectively.** HMRC does not currently hold important information about charities claiming tax reliefs, including details of their activities, income, expenditure and assets, and has not maximised its potential to learn more by sharing information with the charity regulators, such as the Charity Commission for England and Wales. HMRC currently requires around 10 per cent of charities that have made recent Gift Aid claims to make a tax return, and intends to increase the number of charities it asks for this information to improve its profiling of customers and assessments of risk. This will allow HMRC to better target those claims which present a risk (paragraphs 2.34 to 2.37).

Conclusion on value for money

25 Gift Aid provides an important source of income for many charities and reflects Parliament's intention that the income of charities should not be taxed where it is used for charitable purposes. There is welcome evidence that HMRC has strengthened its measures to counter the risk of the abuse of reliefs on donations. However, there is insufficient evidence to conclude that reliefs on donations in their current form, and the way they are implemented, provide value for money.

26 First, there is insufficient evidence that government actively encourages take-up of these reliefs so that those charities which are entitled to them receive the intended benefits. Second, the effectiveness of changes made in 2000 to increase charitable giving is not proven. HMRC's research on the impact of the changes does not allow a clear conclusion to be drawn, and there is an absence of evidence that would demonstrate that the increased cost to the exchequer has resulted in an increase in the value of donations to charity.

Recommendations

a **HMRC and HM Treasury should collect better evidence on the impact of reliefs on donor behaviour, working with the charitable sector and academics to obtain this.** The evidence so far collected has not been sufficient to conclude on whether the incentives provided to donors are working as intended, or whether Gift Aid makes the tax system sufficiently easy for charities to claim the relief. Greater joint working with the charitable sector on data collection and analysis could provider a richer evidence base from which to assess the impact of reliefs.

b **When changes are made to the rules governing tax expenditures, HM Treasury and HMRC should consider what evidence will be required for evaluation and put in place mechanisms to collect it.** HMRC should consider what is proportionate and feasible for it to collect in order to assess whether the stated objectives are being met; to inform potential changes that might improve the relief's effectiveness; and to provide an evidence base to inform the design of other reliefs.

c **HMRC should undertake regular assessments of the losses from Gift Aid and reliefs on donations.** HMRC plans to undertake a full assessment of the losses for charity tax reliefs in autumn 2013. HMRC should assess the costs of undertaking this assessment against the benefits of the information it provides and should consider how best to update the estimate in future.

d **HMRC should evaluate ways to reduce losses from avoidance.** HMRC has successfully increased the impact of its interventions, but more focus is required on tackling avoidance.

e **HMRC should ensure there are better internal flows of information to its charities team.** The team with overall responsibility for charities should establish formal agreements with other parts of the business to ensure full information and data sharing. This should include providing better management information on yields.

f **HMRC needs to better understand its customers in the charitable sector in order to improve its ability to identify risk.** HMRC is planning to obtain more information on its customers. HMRC should develop more detailed customer profiles to help it assess which charities, individuals or companies require review.

g **HMRC should work more closely with the Charity Commission and other regulators of charities to identify and resolve potential problems with the tax affairs and running of charities.** They need to share information more effectively and collaborate on the risk profiling of charities. To do so they will need a better mutual understanding of the organisations' information requirements and ways of working.