

# *lifetime legacies*

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## **Lifetime Legacies: Proposals from charity sector**

**November 2004**

### **1. Introduction**

The charity sector is very appreciative of the measures that the government has introduced to encourage donations to charities and the assistance that has been given to promote them. This partnership between the government and the sector has resulted in a significant increase in donations that are made tax effectively, which have risen from 10% of all donations (made under covenant) in 1997 to over 30% in the last financial year. Although the sector recognises that there is still work to do to increase take-up of tax-effective giving schemes by donors, it is also clear that there is a significant group of relatively affluent individuals for whom the existing tax reliefs do not provide sufficient incentive to give. As a result, a coalition of groups and individuals in the sector has looked at what further incentives could be introduced that would encourage this group to contribute more to the charitable sector in the UK. Having considered the experience in other countries, it is clear that an important piece of the “giving jigsaw” would be the introduction in the UK of Lifetime Legacies.

### **Charitable Remainder Trusts [CRT]**

Tax-effective Charitable Remainder Trusts<sup>1</sup> would provide added flexibility to the charitable fundraising community. The sector most favours CRTs because they resemble a charitable legacy or deferred gift with several important advantages for both charities and donors. As a result, there is widespread support in the sector for calling them Lifetime Legacies.

- The charity receives a clear and irrevocable commitment from the donor. This offers greater security than legacies, which do not always materialise.
- The charity can rely on eventual receipt of a lump sum; this would have critical impacts on fund-raising for capital projects or endowment-building, both of which require sums in substantial tranches. For a major building campaign, for example, a charity could undertake capital expenditure commitments secure in the knowledge that committed funds would be forthcoming.

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<sup>1</sup> Detailed information on how Charitable Remainder Trusts work in the US has already been given to officials in the Inland Revenue but further detail can be provided if necessary.

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*Lifetime Legacies is a coalition of the following organisations and professionals:*

*- Associations -*

*Association of Charitable Foundations; Charities Aid Foundation; Charities' Tax Reform Group;  
Council for the Advancement of Support for Education (Case); European Association for Planned Giving;  
Institute of Fundraising; Institute for Philanthropy; National Council for Voluntary Organisations*

*- Charities -*

*British Heart Foundation; Canterbury Cathedral; Help the Aged; London Business School;  
Marie Curie Cancer Care; National Trust; Royal Academy; Save the Children; Tate*

*- Professionals -*

*Richard Cassell, Withers LLP; Vicky Dyer, Central Lobby Consultants; Paul Knox, Ernst and Young LLP;  
Theresa Lloyd, formerly Director of Philanthropy UK; Sam Macdonald, Farrer & Co*

- The CRT means that the promised future gift can be acknowledged by the charity, thereby deepening the donor's involvement with the charity during his/her lifetime.
- CRTs address the issue of potential donors' fears about financial insecurities in old age and their desire to safeguard their future income needs.

The experience of UK charities that raise donations in the United States demonstrates the effectiveness of CRTs in encouraging a certain type of donor. They would unlock new money for charities. Individuals who wish to make a commitment to charity, but who are unable or unwilling to release assets immediately are attracted by CRTs because of the security they offer of an assured income during their / or a specified beneficiary's lifetime, after which the capital passes to a charity under the terms of the trust. Experience in the US also demonstrates that a CRT gift frequently leads to enhanced giving by the donor.

## 2. **Present tax Position of CRTs in the UK**

While CRTs can be established in the UK at present, their tax treatment does not recognise the irrevocable commitment of resources to charity that they entail; nor is there any incentive to make planned gifts of this kind. In particular, the capital gains tax treatment of CRTs penalises their use as compared with a legacy. Placing CRTs in the same position as legacies would materially enhance planned charitable giving without, over an extended period of time, resulting in a significant loss of revenue since it is merely bringing forward the capital gains tax relief rather than introducing a new relief. In addition, we advocate a deduction against income tax.

Charities, both in the UK and around the world, enjoy exemption from most forms of taxation because they serve a public good. Donations to charities benefit from additional tax incentives. Legacies enjoy both capital gains tax and inheritance tax exemption. The lack of tax incentive for CRTs seems inconsistent with this general philosophy.

## 3. **Outline of Tax Charges**

### • **Income tax on settlement**

At present, no tax advantage is offered against a donor's income tax liability in recognition of the settlement of funds on a CRT. We propose that the discounted present value of the future receipt by the charity should form the basis of a limited deduction against the settlor's taxable income. This would provide a modest incentive to make a capital gift using a CRT rather than leaving a legacy. This does not compare with an outright gift and should be regarded as the equivalent of a legacy brought forward. Given the reduced amount of tax deduction it should be regarded as distinct from gifts qualifying for Gift Aid.

The period of the interest in possession and the investment policy (ie weighting in favour of income or capital growth) would be the principal variables in calculating the relevant present value. The former should be straightforward to calculate. The latter could either be calculated by reference to annuity models or by imposing investment policy restrictions and using projected income yields. Ideally, the tax credit should be available to be carried forward against future years' taxable income.

### • **Income tax during period of interest in possession**

The income payable to the individual would be fully liable to income tax. However, the trust itself should be exempted from any further income tax liability because any

income accumulated within the trust and accruing to capital would pass to charity. There should be no tax loss to the Treasury since only income applied for charitable purposes would be exempt.

- **Capital Gains Tax**

Gifts into the trust should qualify for CGT relief given that the settlor will have irrevocably given away his entire interest in the capital value of the assets for charitable purposes. Assets used to fund a legacy would receive a tax free uplift on death and so gifts to a CRT should similarly be exempt. There would be no tax loss compared with a legacy.

Disposals made by the trust should also be fully exempted from CGT since the capital will pass to charity.

- **Inheritance Tax**

The gift into the trust should benefit from the full IHT exemption available under section 23 IHTA 1984 (although we would accept that, in circumstances where an income entitlement was transferred, the value of that entitlement would be dealt with in the normal way for IHT purposes).

#### 4. **The potential donor**

Informal research suggests that CRTs would appeal to the type of potential donors that charities are keen to attract but with whom they have had limited success so far. The asset-rich are not, as a category, as generous in relative terms as either the very wealthy or those with little or no assets. This research is borne out in other countries where the schemes are targeted at the “mass affluent” rather than the exceptionally wealthy. An examination of the types of US institutions which encourage such giving supports this. Typical donors in the United States and, by implication, in the UK, may have a second home and a reasonable pension; they are enjoying retirement and their children are independent, although they may still have dependent parents, and they have to plan for their own old age. Promising the second home to a charity on the death of the second partner, and obtaining tax relief at the time of the pledge, is an attractive element of schemes operating in the US.

The asset-rich in the UK typically give out of income either sporadically or to a lesser degree on a planned basis but they are nervous about long-term commitments and the prospect of reduced income as they grow older. They are consequently wary about reducing their asset base for fear that they might need to use it as an income-supplement at some point in the future. A scheme that would allow them to use their assets to realise income, with tax reliefs, would meet these concerns.

#### 5. **Anti-Avoidance**

- **Procedure – standardised forms**

The sector is keen to ensure that there is no abuse of tax incentives on donations to charity, not least because widespread wrongdoing could bring about a serious loss of public confidence in charities as a whole. We believe that this could be dealt with by using only prescribed and approved forms for the establishment of CRTs combined with controls over who may act as trustee(s). Provided that there were standard forms approved by Inland Revenue and the Charity Commission and tax benefits were dependent upon the use of these forms, opportunities for abuse would be minimised.

This would also minimise the administrative burden on the Inland Revenue and the Charity Commission.

- **Trustees**

The role of the trustee will also be crucial in avoiding abuse. The law already requires trustees to balance the interests of income and remainder beneficiaries. We recommend that there should be a requirement to notify a named charity of the gift and the charity should, as a minimum, be given certain information and possibly specific enforcement powers. As a named beneficiary, the charity would have a formal duty to police the arrangement. It may also be useful to have in place restrictions in terms of investment policy. We also recommend that CRTs should be run either by charities or by investment houses which would bring them under the aegis of the FSA's supervision.

## 6. **Conclusions**

We believe that the introduction of tax incentives to promote the use of CRTs would provide a welcome, long-term boost to the fundraising sector that would result in increased levels of giving to charities within the UK. The fact that several representative bodies and a number of major charities have come together to research and promote these giving schemes demonstrates the level of support for their introduction in the UK.

The attached annex contains a number of comments from fundraisers, charities and donors, including case-studies (which have to be anonymous) that illustrate both the effectiveness of CRTs as well as examples where their absence has led to missed opportunities for UK charities. We believe that the modest adjustments to the tax rules, which would sit alongside and complement existing tax breaks for charities (including Gift Aid and share relief), would be an important component in modernising the tax code to meet the needs of today's market and of the charitable sector. By adding to the overall wealth and strength of the UK's charitable community they would enhance the contribution that the sector makes to society.

In summary, we recommend the introduction of CRTs because:

- i) they address the question of people's insecurity about giving away capital from which they (might) need the income. This is of particular significance in view of the worries many harbour over pension provision, longer life expectations and increasing costs of care in old age
- ii) they encourage planning and a strategic approach to philanthropy which can involve other members of the family
- iii) the beneficiary charity will be able to manage the relationship in a way that could strengthen the links between the donor and the institution, and possibly lead to further gifts, particularly if family members observe the donor's pleasure from the association forged with the charity
- iv) they are an effective way for the government to work in partnership with the charitable sector to enhance the scope for philanthropic activity among groups that have been identified as relatively reluctant givers in terms of their wealth and disposable income.

## **APPENDIX – CASE STUDIES**

### **Examples/comments from UK charities:**

#### **Sir Peter Lampl, Member of the Government Task Force on Voluntary Giving to Higher Education supported by the Association of Charitable Foundations**

"Planned giving is an increasingly important area of fundraising in the US. With the huge rise in property values and the decline in family size in the UK this is a significant potential source of funding for British universities".

#### **Charity one:**

A project which helps children with a certain disability is trying to raise £15m for a new permanent building. It will take some years to raise the money and some 40% of the costs are therefore linked to inflation.

In principle the charity would be able to borrow, because the children who use the service are "statemented" and there is guaranteed income from local authorities, albeit it does not cover the actual costs of looking after the children. Money comes from fundraising, mostly from trusts and foundations. However the trustees are understandably very reluctant to borrow because of the risk and likely costs, and they would be fundraising to pay back a loan – not the greatest of incentives for donors.

If the trustees were able to benefit from tax-efficient CRTs, they could borrow from a bank against the security of the legal commitment of the money coming to them. The charity would not only save the 40% built-in inflationary building costs, it would also save much of the fundraising costs. They would still have to nurture donors, of course, and could either pay interest on the loan out of revenue or roll it up and pay it with the capital as the remainder trusts mature.

#### **Charity two – London Business School:**

The Director of Development at London Business School, Don Kirkwood, is an American with significant planned giving experience in the United States. One of his first actions at London Business School was to produce the School's first legacy brochure - a brochure which served to promote legacies from UK alumni but which also heavily promoted the traditional planned giving opportunities of charitable remainder trusts to the School's US taxpaying alumni (an option through The American Friends of London Business School - a 501 (c) 3 organisation). He strongly believes that the availability of CRTs in the UK would have very broad appeal to the School's alumni, and could play a significant role in any future fundraising and development campaign.

#### **Charity three – Newcastle University:**

Miss X has a second home to which she now finds it difficult to drive, and anticipates she will not be able to use at all within a matter of months/years. She is very interested in being able to gift the house immediately to the University with tax benefits for everyone, but still make occasional use of it during her lifetime or for an agreed set period.

Alternatively, as and when she can no longer make use of the second house, she would like to either give it to the University to sell, or sell it herself and give the proceeds to the University (whichever is more tax-efficient), and then receive an annual income from the resulting lump sum, in case it is needed for contingencies (such as nursing fees) in the future.

**Comments from potential donor:**

A senior City banker, who has been involved in a major way with his US university and who is also supportive as a trustee or board member of UK higher education and arts organisations, has considerable experience of giving and raising money in US and UK. The US tax code gives him more incentive to give in the US than the UK. He writes:

“Having just established such a trust to benefit my University I am a proponent of such vehicles to benefit both the donor and the recipient. For the donor the benefits are clear; no capital gains tax on the asset put in the trust. In my case it was a house in Florida that had appreciated substantially over the past 15 years. The University then sold the house to raise cash which will be invested in a diversified portfolio of equities and fixed income investments. I, of course, derived a charitable deduction which will reduce my Federal Income Tax bill. And, for me, the most compelling reason to establish a CRT was the fact that I will receive a 6.5% return annually on the funds that the University realised by selling the house. My wife and/or I will continue to receive this return until we are both dead. The promise of this income made it possible for me to make a much larger gift to my University than I would have contemplated had it been an outright cash gift from me to the University. One benefit for the University is that if they invest the corpus of the Trust well they should earn a return over and above the 6.5% they pay me annually so that the Trust may experience capital growth between now and when both my wife and I have passed.

“As we know can occur, some donors have not been able to honour significant pledges if their circumstances change so the recipient cannot truly count on the gift. With a CRT, my University has the cash on their balance sheet and under their investment control so there is no way the donor can default on a pledge. We are about to undertake a major campaign at my University and it is clear to me that if we are going to raise the goal which is measured in hundreds of millions of dollars, we will have to generate larger gifts than we have in the past. I think it is a very powerful tool to maximize the giving capacity of significant philanthropists. I believe a CRT type of vehicle here in the UK would have a similar effect on certain UK donors. Obviously, charities here in the UK would need to develop the sophistication to deal with the marketing of CRTs and the ability to structure and manage the Trust instruments, but that is a worthwhile challenge in order to raise the level of philanthropy to the next level.”

**Comment from a tax adviser:**

“The introduction of CRTs will be an important additional incentive that will complement gift aid. I have many clients who make gift aid payments who would welcome this additional form of relief.”

**Evidence from a US museum:**

The Metropolitan Museum is aware of 27 charitable remainder trusts designated for the eventual benefit of the museum. The trusts range in size from tens of thousands to tens of millions. The trusts under \$100,000 are mostly portions of larger trusts benefiting several organizations where a fraction has been designated for the Museum.

An official at the museum states: “While issues of confidentiality prohibit me from referring to individual gifts or specific cases, I think it is fair to state that none of these gifts would have been made if they were not established as charitable remainder trusts - or at least they would not have been as large. The charm of the remainder trust is allowing the donor to do two

things with one asset - dividing the income and the principal and using them for different purposes - which often opens the door to a much more significant gift.

“Additionally, it may be worth noting that I have seen an increase in the number of inquiries where the donor wishes to take a large portion of their estate, or even their entire estate, and fund a charitable remainder trust with it at their death which will also benefit either a spouse, sibling or someone else close to them.”

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