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Giving to charity in life and death

How to include charitable donations in your tax planning strategy.

Incorporating charitable giving into your tax planning strategy can be a useful way to reduce both your income tax and the inheritance tax (IHT) that will eventually become payable on your estate.

As such, gifts may become an important component of both the estate planning process and the more immediate goals of reducing your income tax bill.

You can make charitable gifts at any time during your lifetime and posthumous gifts can be written into your will.

Gifting and income tax

Making gifts through payroll

Payroll giving schemes allow you to donate to charity directly from your wages or your pension. The donations will be made before your employer deducts tax from your gross pay.

The amount of tax relief you get will therefore depend on your marginal rate of tax:

- basic rate taxpayers: 20% tax relief
- higher rate taxpayers: 40% tax relief
- additional rate taxpayers: 45% tax relief.

Of course, access to payroll giving schemes is dependent on your employer operating one.

Talk to your employer to find out whether this option is available to you.

Gift aid

There are tax incentives for higher and additional rate taxpayers to make charitable donations through gift aid.

Gift aid is a government scheme that allows charities and certain community sports clubs to claim an additional 25% of any donation you make.

Higher and additional rate taxpayers can then claim the difference between the rate they pay and the 20% basic rate of tax on the amount donated.

Donations will not qualify for gift aid if they're more than four times what you have paid in income tax and/or capital gains tax (CGT) in the previous tax year.

Donating through gift aid is simple. You must send the charity a gift aid declaration form containing your personal details and the amount you want to donate.

Example

John donates £500 to a charity. The charity claims the gift aid on the donation, making the total amount received by the charity £625. As a higher rate taxpayer John can claim tax relief on the difference between the higher rate (40%) and the basic rate (20%) on the gross donation – which in this case is 20%. He therefore claims £125 in tax relief on his donation (£625 x 20%).

Gifting non-cash assets

No tax is payable on assets, such as shares, property and land, that you gift to charity or sell to a charity at below market value.

Donations of such non-cash assets are therefore usually exempt of both income tax and CGT.

You can claim income tax relief on such donations by deducting the value from your total taxable income when completing your self-assessment tax return.

Note that you may be liable for CGT if you sell land, shares or property to a charity for less than the market value but for more than you paid for them.

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Giving to charity in life and death

Gifting and inheritance tax

It is possible to reduce the amount of IHT charged on your estate by making strategic gifts and charitable donations.

This can be done by making gifts during your lifetime and writing donations into your will.

Inheritance tax-exempt gifts

Gifts to charities and political parties are exempt from IHT.

The annual exemption allows you to make up to £3,000 in IHT-free gifts every financial year.

Any gifts made below this amount will not be considered part of your estate when HMRC calculates your IHT liability.

The annual exemption can be carried forward by one year if you fail to use it all in a single tax year.

There are other IHT-exempt gifts in addition to the annual exemption amount.

During each tax year you can:

- spend up to £1,000 in wedding and civil ceremony presents per person (this increases to £5,000 for a child of your own who is getting married and £2,500 for a grandchild or great-grandchild)
- give presents out of your income, such as birthday and Christmas gifts (though doing so should not affect your standard of living)
- give up to £250 in small gifts to as many people you want
- give financial support to a family member (for example, a child or an elderly person).

With the exception of the small £250 gifts, these exemptions can be combined to be used on the same person.

If, for example, your child gets married you are able to make IHT-exempt birthday and wedding gifts in the same year. However, you are unable to gift a wedding present if you have already given them a £250 gift.

Potentially exempt transfers

Potentially exempt transfers (PETs) are gifts made during your lifetime that may be exempt from IHT depending on how long you live for after the transfer is made.

The gift will be IHT-free if you live for seven years after the transfer date.

Dying within the seven-year period will result in an IHT charge to be paid by the recipient of the gift.

The rate of IHT will be determined by the number of years you lived after making the transfer. The longer you live, the bigger the IHT reduction.

This is known as taper relief and operates as follows:

Years between gift and death	Tax paid
Less than 3	40%
3 to 4	32%
4 to 5	24%
5 to 6	16%
6 to 7	8%
More than 7	0%

Writing gifts into your will

Any charitable donations written into your will are not considered part of your estate for IHT purposes.

What's more, your estate will benefit from a reduced 36% IHT rate should you leave 10% of your net estate to charity.

Example

Alice has an estate whose total value is £1.5 million. The net value of her estate is therefore £1.175 million (£1.5 million - £325,000 IHT nil-rate band). Alice will be charged the 40% IHT rate, resulting in £470,000 going to the taxman (£1.175 million x 40%).

Instead, Alice can leave 10% of her net estate to charity (£117,500). What remains of her net estate (£1,057,500) will be charged the reduced 36% IHT rate. This means that she will be taxed £380,700 (£1,057,500 x 36%) instead of £470,000, saving her £89,300 in tax.

You have two options when it comes to gifting assets to charity in your will: **pecuniary legacies** and **residuary legacies**.

Pecuniary legacies involve leaving a fixed sum of money to a designated charity, while residuary legacies provide the charity with a share of your estate once any liabilities have been settled and legacies paid out.

Ensure you include the following information when writing a charity into your will:

- the name of the charity
- the registered number and address of the charity
- a receipt clause: this allows the charity to accept the legacy
- a merger clause: this provides your executor with flexibility about the destination of the donation should the charity merge or stop operating.

Contact us to discuss your tax planning strategy.