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Pointmaker

A STEP CHANGE IN UK PHILANTHROPY

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SUMMARY

- The growth in the income of the charitable sector in recent years has come not from increased philanthropy, but from increased government spending. This is despite various campaigns and reforms in the tax system, both of which were designed to increase public donations to charities.
- The current economic difficulties are likely to put pressure on the level of public donations to charity. Equally, probable constraints on government spending will also constrict charities' income in the years ahead.
- It is therefore more important than ever to maximise the level of charitable donations from the public. Two straightforward reforms, both targeted at the reasonably well-off, could achieve this while also greatly invigorating the smaller charity sector.
- The first reform would enable individuals to set up 'Remainder Trusts' in which sums of £50,000 or more could be settled. Crucially, donors would retain control over the capital – and could reclaim it if they wished – during their lifetime.
- The second reform would be the creation of a new type of charity – the 'Personal Charitable Trust' – based on the Canadian and US models. These Personal Charitable Trusts would enjoy the benefits of a light touch regulation free of many of the onerous reporting burdens imposed on larger charities. They would also offer donors the option of anonymity.
- These reforms could unlock some of the £740 billion held by the 820,000 Britons with a net wealth of more than £500,000. If just 10% of this sum were realised, then an additional endowment of £74 billion would be made available for good works.

INTRODUCTION

This paper proposes changes to the fiscal, legal and regulatory environment for individuals planning to give sums of £50,000 or more to charity.

Unlike mass public donations, or at the other extreme the donations of the super-wealthy, these proposals focus on the reasonably well-off: those with a net wealth of £500,000 or more. By making it easier and less onerous for this group to set up charitable trusts, it is hoped that a significant proportion of the £740 billion held by this group could be released for private charity.

THE REVIVAL OF CHARITY

The election of Mrs Thatcher in 1979 saw a great injection of impetus into charitable activity. The empowering of the individual, the encouragement of entrepreneurialism and the creation of wealth led to a renewal of philanthropy, similar in many ways to that found in the US. The creation of the Gift Aid scheme, which greatly simplified tax-effective giving to charity, was to be the vehicle for this 'new philanthropy'. At the same time, the process of 'contracting-out' what were deemed statutory services to charities was accelerated.

The Labour Government of 1997 provided further improvements to the Gift Aid scheme. For example, since 6 April 2000, individuals have been able to get income tax relief on gifts to charity of certain shares, securities and other investments. Individuals can also claim the tax relief if they give, or sell at less than market value, any qualifying investments to a UK charity. The relief has been extended from 6 April 2002 to include gifts of land or buildings.

Other initiatives have widened the pool of donors. The Band Aid Concert of 1986, Comic Relief and Children in Need have demonstrated that the appeal of giving to charity is not limited to the very rich. Indeed, according to the Citizenship Foundation, three out of four people in their teens or twenties are involved in giving and/or charitable activity.

There are further reasons for expecting charitable donations to increase – not least the gradual reduction in the universal nature of the welfare state. For a very short period – from, say, 1946 to the late 1970s – the concept of a welfare state funded by high direct taxation existed. The belief was that charity would wither away. But the charitable instincts of the British people have proved stronger than expected at the time, and the reality of universal welfare has proved weaker. Now, with government spending under great pressure, the opportunity and need for charities will only grow.

SO WHAT IS THE PROBLEM?

Despite the reforms and wishes to create a new age of philanthropy, over the last decade giving by the general public has remained relatively static, both as a percentage of national expenditure (GDP), and as a percentage of charitable income (as the Table below shows).

SOURCES OF CHARITABLE INCOME

Charities	Year	Total Income £ m	% from voluntary donations	% from gov. funding
Top 500 fundraisers	1992-1993	3,300	51%	38%
Top 500 fundraisers	2002-2003	8,587	54%	40%
Top 500 fundraisers	2004-2005	9,724	52%	41%
Top 300 fundraisers[1]	2007-2008	10,109	52%	36%

Source: Unpublished analysis by Professor Cathy Pharoah (Cass Business School), using data from *Charity Trends* (1996, 2003, 2006 Editions) and *Charity Market Monitor*, 2009.

The income of the charitable sector has almost quadrupled over the last two decades, but this growth has been fuelled as much by government funding as by private philanthropy, as the table below, which tracks the income of the major charities who fundraise from the general public, shows. Government income to the charitable sector as a whole has increased in real terms by 20% over the last decade, continuing to provide around 40% of all charities' income. For many charities it is the sole funder. Worryingly, both NCVO and Caritas are predicting that the amount of income from general public donations will decline as the recession deepens. To make matter worse, the level of grant support from private charitable trusts will be constrained by the vagaries of the current investment environment. Corporate cash donations have seen no real growth for at least a decade, with corporates turning increasingly to in-kind support.

This is not to say that the British public is mean. Giving to charity at slightly less than 1% of GDP places the British in second place in the world giving tables, behind the US. Nor are some of the very wealthy not giving, as shown by the examples of Sir Tom Hunter, the Sainsbury family and many others. Legacy income is equally robust.

The greatest opportunity for increasing charitable donations lies with the reasonably well-off (defined as those people who have assets beyond the family home of £500,000 or more). In the late 1980s, academics described the level of donations given by individuals as an inverted U-curve: people are at their most generous at the extremes of wealth of society. The challenge is how to encourage and persuade those in the middle of the wealth curve to give more. To do this, the means and accountability of distribution needs to be slightly changed.

THE CREATION OF A 'REMAINDER TRUST'

Currently, when an individual sets up a charity during his lifetime and transfers money, or certain assets, to it, he will be entitled to tax relief.

Once the transfer has occurred the individual loses all personal rights and claims to the money. But the reality for the reasonably well-off is that many are understandably uncertain about their future circumstances; this uncertainty inhibits their willingness to commit their funds to charity irrevocably: after all, there may be a time in the future when they might need the money back. At present if a person creates a charitable trust and places say 50% of their wealth within it, they will never be able to have personal use of the money.

The alternative would be to set up a 'Remainder Trust' which would allow people to create a charitable trust in which they could deposit a capital sum. The historic capital would remain untouched but the tax-free income generated from the capital would be distributed for charitable purposes. But once a year, less any tax relief obtained, donors would have the option to claim back some or all of the capital if they required it.[2]

At a stroke a new source of financial support would be available for charities. They could look forward to both regular revenue and eventually a capital sum when the donor of the trust dies.

At that point, the trust could be either immediately closed and the capital distributed. Or it may continue for a limited time (say ten years) when members of the family would have the option to continue the trust. This would

[2] For more details on remainder trusts, see Lindsay Driscoll and Peter Grant in *Philanthropy in the 21st Century*, Centre for Charitable Giving, Cass Business School, November 2009.

cascade the practice of giving to charities through generations.

The Charity Law Association has already recommended the creation of Remainder Trusts but its suggestions were in part rejected by the Treasury on the basis of fears of potential tax abuse and the work involved. However, if the rules on qualifying investments are clear and if the request to have capital returned can be made only once a year (less any tax relief), then surely a simple administrative system which HMRC can track is possible.

The benefits to society of the estimated 820,000 Britons with net wealth of more than £500,000 must surely be more important and there must be a way to overcome these administrative issues.[3]

For most of these people, after their houses, the next biggest asset is their pension fund. Many are now in defined contribution (money purchase) arrangements rather than defined benefit (final salary). Those in defined contribution are frequently those of an entrepreneurial nature: the very people the Remainder Trust reform is targeted at.

For better or for worse, they have embraced the risk of direct market investment, often doing everything within their powers to avoid the purchase of a conventional annuity. Amongst the variety of annuity alternatives available, the majority allow for charitable giving upon death. Remainder Trusts, along the lines proposed, could be eligible as an alternative to the purchase of an annuity. With donors being able to reclaim the original capital should they fall on hard times, Remainder Trusts could be expected to accelerate donations from those planning their pension provisions. This would effectively forward fund charitable projects and increase the generation of social capital.

ANONYMITY AND DISTRIBUTION

The current transparency and accountability requirements for charities have two problems:

- they impose a considerable compliance cost in time and professional fees;
- they enable anyone to know who the trustees of a charity are.

While some donors may be happy to be in the public spotlight, for a number of reasons – including personal security – most people wish to give quietly and anonymously.

To resolve the twin issues of compliance costs and of privacy, it is proposed that a new category of charity is created: the 'Personal Charitable Trust'. These would have a light touch reporting requirement and be relieved of much of the administration and reporting duties that applies to public fundraising charities and the professional and corporate grant-making trusts.

To ensure, however, that the Gladstone principles are adhered to,[4] these private charities should comply with a requirement that they have to distribute a minimum of say 5% or 3.5% of their capital each year. (This is

[3] Sources on the size and asset holding of affluent individuals do not enjoy the same statistical accuracy as the above surveys. The figures quoted were taken from the published Brewin Dolphin Wealth Management reports as their figures were in the middle of the various unpublished research from other wealth managers and accountancy firms that I have seen. Unlike high street banking which is dominated by a few players no single wealth manager has more than 10% of the market.

[4] William Gladstone observed that 'one man's tax relief, is another man's tax burden'. This objection is met by the 'mutual exchange of benefit' that has been the foundation of tax relief for charities and charitable giving.

broadly what happens in the US and Canada). This distribution should be averaged, over say a rolling period of five years so that larger capital projects or fluctuations in the investment market can be smoothed. As in Canada, there would be a case for a separate, 'small personal charity regulation unit' within the Charity Commission to ensure that abuse does not occur and that the principle of public benefit is adhered to.

This would also ensure that these charities had to manage their investments effectively – usually through a professional manager – to ensure that the capital was not eroded. Currently, many of the top UK charitable trusts distribute less than 3% of their capital each year and have been accused of poor investment management because there is no requirement to distribute.[5] The minimum distribution rules would obviate these criticisms for the proposed 'small personal charitable trusts'.

These private charities should also automatically cease on the death of the founder or within ten years of death, unless relatives wish to continue and put in new capital. This means that these charities automatically have a limited but effective life.

CONCLUSION: ACT NOW

Critics sometimes claim that there are too many charities. In many respects they are right. But what they are referring to are the number of charities that raise funds from the public and whose purposes seem to overlap with each other. The proposals made here are intended to re-energise the charity sector with endowed charities, which have independent income. These new charities would not be a burden on the public and would not be expected to undertake public fund-raising.

At a time of recession it may seem somewhat incongruous to be arguing for changes in philanthropy. Yet if not now, when? Indeed, the call upon charities to assist the poor but also engage in a whole plethora of 'civil society' activities is needed now more than any other time in the last 20 years.

Recent reforms have not increased public donations. These reforms offer a practical and cost effective method to unlock the potential £740 billion held by the estimated 820,000 Britons with a net wealth of more than £500,000. If just 10% were realised this would mean an additional endowment of £74 billion for the UK voluntary sector.

For enacting two small reforms, this surely could be a great potential benefit.

[5] For criticism of the investment management policies of charities, see Institute of Philanthropy, *Investment Matters: In search of better charity asset management,* 2008.

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