

The Calman Commission

Implications for Charity Tax Reliefs

Background

Professor Sir Kenneth Calman's Commission (the "Calman Commission") reviewed the provisions of the Scotland Act 1998 which includes powers to enable the Scottish Parliament to vary the basic rate of tax for Scottish taxpayers. The Calman Commission published its report on 15 June 2009.

The Coalition Government has made a commitment to implement the recommendations of the Calman Commission. The full report of the Calman Commission can be found here:

<http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-final-report-2009bookmarked.pdf>

Calman proposals for income tax

The Calman Commission's proposals on income tax are for the UK Parliament to reduce the 20 pence basic rate, the 40 pence higher rate and the 50 pence additional rate of income tax that apply to all UK income tax payers to 10 pence, 30 pence and 40 pence respectively for Scottish tax payers. Simultaneously there would be:

- a corresponding reduction in the block grant; and
- provisions to allow the Scottish Parliament to a new Scottish rate of income tax which will apply equally to all of the main UK income tax rates.

Example 1:

- UK basic rate = 20% and Scottish Rate set at 11%
- Scottish taxpayer will pay 21%, with 11% going to Scottish Government and 10% to UK.

Example 2:

- UK basic rate = 20% and Scottish Rate set at 9%
- Scottish taxpayer will pay 19%, with 9% going to Scottish Government and 10% to UK.

The new Scottish rate of income tax will need to be set every year by the Scottish Government and subject to the approval of the Scottish Parliament.

The new tax provisions for Scotland would replace the Scottish Parliament's powers to vary the rate of income tax paid by Scottish tax payers by up to 3 pence (the "Scottish Variable Rate").

There will be a test to identify whether an individual who is a UK resident for tax purposes is liable to the Scottish rates of income tax. The test will be based broadly on with which part of the UK the individual has the closest connection.

The Commission recommended that the new Scottish rate of income tax would be collected by HMRC and that everything else in relation to income tax, aside from the rates, would remain a reserved matter for UK Parliament.

A High Level Implementation Group has been established, chaired jointly by the Exchequer Secretary to the Treasury and the Secretary of State for Scotland. The first meeting was held on the 26 July 2010. HMRC has also established a number of Technical Groups.

The purpose of the charity tax technical group is to consider the implementation of the Calman proposals in relation to charity taxation.

Charity Tax reliefs

In this paper, for convenience, references to "Scottish rates" mean the rates that will apply to taxpayers liable to income tax at the Scottish rates (Scottish taxpayers) and "UK" rates mean the rates that apply to other UK taxpayers.. .

There are many tax reliefs available in the UK but the only ones where a potential impact has been identified (aside from those as employers) are:

- Gift Aid.
- Payroll Giving.
- Gifts of shares and land.
- Tax paid by charity trustees.

Taking each one in turn:

Gift Aid

In simple terms Gift Aid works by allowing charities to reclaim the basic rate income tax donors have paid on the money the donor gives to the charity. Any higher rate tax relief is claimed by the donor through PAYE or SA. In order for the charity to reclaim the basic rate tax the donor has to provide a “Gift Aid Declaration” (GAD) confirming they have paid sufficient tax to cover the tax the charity will reclaim.

Gift Aid is now available to charities based in the EU, Norway and Iceland.

Charities reclaim the basic rate Gift Aid tax from HMRC on form R68. These forms are all paper based and processed manually. HMRC pays out about 160,000 claims a year totalling £1bn in Gift Aid.

The question to be considered is whether or not only the Scottish or the UK rates will apply to Gift Aid relief across the whole of the UK.

The Scottish Variable Rate allowed for the basic rate of income tax only to be varied. Under the SVR all Gift Aid was to be paid to charities at the UK basic rate.

If the UK rates do not apply to Gift Aid reclaimed by charities, then the donations by Scottish taxpayers would be treated as paid under deduction of

Scottish basic rate tax and donations from other UK taxpayers would be treated as paid under deduction of UK basic rate tax.

Individuals paying the higher rate of income tax can also reclaim Gift Aid and consideration needs to be given as to whether that should be at the UK rates or the Scottish rates.

Option 1: UK basic rate applies to all donations

For Gift Aid this would mean the system would continue to operate as now. So charities would not incur any new burdens or processes. If the basic rate in Scotland remains equal to the UK rate (i.e. the additional levy is 10 pence) then no problems can be foreseen. However if the Scottish rate is different it would have impacts:

Scottish rate lower than UK rate

This has minimal administrative impact as the Gift Aid provisions still ensure the donor has paid enough tax to cover the Gift Aid the charity reclaims. So the current rules and processes still work with little noticeable difference. It is possible a few more people would make incorrect Gift Aid declarations where they donate enough to bring their total income below the personal allowance, but that is going to be rare.

Scottish rate higher than UK rate

There would be no “tax to cover” issue but charities may feel they are losing out on the extra income they could have received from donors liable to the Scottish rate of income tax if the Scottish rate applied to Gift Aid.

Option 2: Scottish basic rate applies to donations from Scottish taxpayers

There would need to be a significant change to the Gift Aid system and it would have to apply to all charities, not just those in Scotland, as any charity may get a donation from a Scottish taxpayer. Charities would need to know if the donor was a Scottish taxpayer or not and the Gift Aid Declaration would

have to be expanded to cover this. All donors would have to declare this as it will impact what rate of tax the charity could reclaim. The charities would then have to keep “Scottish” and “non-Scottish” donations separate and prepare two separate Gift Aid claims. This would be an increased administrative burden on charities.

For donors, especially those with no Scottish connections this will be potentially very confusing, especially when asked on the GAD to state whether they are “Scottish” taxpayers or not.

Additional problems will arise for people who are mobile and may not know if they are Scottish taxpayers when they make a donation early in the year. The test of whether an individual is a ‘Scottish taxpayers’ is for the year so donors will possibly be making donations before they know what their tax status will be. This will lead to the need for more balancing adjustments between the donors and HMRC. Given the number of people we anticipate will move in and out of Scotland each year this could be a significant administrative issue for donors.

Scottish rate lower than UK rate

Charities would get less income from donations made by Scottish taxpayers and all charities have additional administrative burdens because of the need to distinguish Scottish taxpayers.

Scottish rate the same as UK rate

If the rate was the same charities would receive the same income but still have the extra admin burden.

Scottish rate higher than UK rate

If the Scottish rate was higher charities would get more income from donations by Scottish taxpayers but whether this would be enough to cover the additional costs would depend on how many Scottish donors they have,

how much those donors give and the actual rate of Scottish tax. All charities would have additional administrative burdens.

Impacts on higher and additional rates.

If the UK basic rate applies to Gift Aid it does not follow the UK higher rates would have to apply for Scottish donors. As higher rates of relief are given through PAYE or SA it should be possible, with some adjustments to the respective systems, to give relief at Scottish rates even if the rate reclaimed by charities is at the UK rate. Decisions here will be influenced by what is decided for other tax reliefs, how easy the changes can be communicated to customers and system limitations. Higher rates of relief are given through PAYE or SA and enhancements could be carried out to HMRC's systems as part of the implementations to wider Calman proposals.

If the Scottish basic rate were to apply it would follow that higher rate and additional rate relief would also be at the individual's marginal rate.

Impacts on HMRC

Changes will need to be made to HMRC's systems and processes. The extent of those changes will be influenced by how different reliefs and types of income are treated and as such the treatment of gift aid will be a contributing factor.

If charities continued to reclaim Gift Aid at the UK basic rate there would be minimal impact on HMRC from that part of the process. As mentioned above there may be a few more "tax to cover" issues with individual donors but these would be relatively insignificant. HMRC would need to introduce changes under SA to compute the amount of any higher rate relief for a Scottish donor under Gift Aid and changes to the PAYE system which extends the basic rate band to take into account donations made under Gift Aid depending on what is decided for higher rates of relief.

If the Scottish basic rate applied to Gift Aid:

- Potentially this would double the number of claims HMRC receives assuming on average every claim contains at least one donation from a Scottish taxpayer. This would at least double the number of people HMRC would need to process returns. The additional complexity is likely to result in more errors in claims so HMRC would need extra staff for correcting errors. There would be a need for further additional resources to carry out the checks on individuals who started or ceased to be Scottish taxpayers part way through a year and to collect the balancing amounts due from some of them.
- HMRC would again need to introduce changes under SA to compute the amount of any higher rate and additional rate relief for a Scottish donor under Gift Aid and changes to the PAYE system which extends the basic rate band to take into account donations made under Gift Aid.
- The existing IT system for Gift Aid cannot cope with two different basic rates. Substantial enhancements would be needed.
- There would be additional compliance work and Audits needed to check the right rate had been claimed.

On current estimates HMRC would need around 80-100 more staff to deal with all this on top of the cost of enhancing the various IT systems.

Payroll Giving

Under a Payroll Giving scheme the employer deducts the donation to charity from gross pay before applying tax to the net amount. Therefore the rate of tax relief given is automatically at the individual's appropriate marginal rate and has no bearing on the amount donated or the Payroll Giving scheme.

Some employers operate a form of Payroll Giving where a deduction is made from net pay. However such a donation is treated as a donation under Gift Aid by the charity and HMRC so the section above on Gift Aid covers this point.

Gifts of shares and land

Individuals who donate certain shares or land to a charity qualify for income tax relief. All the tax relief has to be claimed through the SA return. It would therefore be possible for tax relief to be given to the individual at their “Scottish” rates or at the UK rates. Which route is taken will depend on what is decided for other similar reliefs.

Tax paid by charity trustees

Income tax arising on trustees and trusts is not within Calman and would continue to apply therefore at the UK trust rates.

Questions for charities

- 1) Gift Aid: Would you prefer the UK basic rate or Scottish basic rate to apply to donations made by Scottish taxpayers? Can you give some reasoning for your choice?
- 2) If the UK basic rate is applied to Gift Aid reclaimed by the charity, do you think the UK higher and additional rates should apply to higher rate and additional rate relief claimed by a Scottish donor, or the Scottish rates?
- 3) Are there any problems HMRC has not identified?

HMRC Charities

7 January 2011