

**“Philanthropy in the 21st Century”
Coutts Conference, 17 June 2004
Speech by Hilary Browne-Wilkinson**

I have been asked to set the scene for the discussion of Philanthropy in the 21st century in Britain.

By philanthropy we mean private contributions for public purposes by individuals, corporations and foundations, though today I will concentrate on an individual giving.

Although there has been a strong tradition of philanthropy in the UK, the second world war, left Britain poor and exhausted with a government determined to provide a society which offered health, education, the arts and insurance in old age to all classes and income groups. To support the Welfare State, taxes had to be raised higher and higher until the late 1970's when there was a rebellion from the voters - the government was changed, taxes were lowered and have remained lower for over 20 years. (NOTE 1)

This has a twofold effect – less money for the government but more for the individual. With diminished government funding, we must turn to other means of supporting public purposes – philanthropy being one; another being the revenue creation of the charity itself (but I will not go into that).

In our attempts to rebuild a culture of philanthropy, we look to America where the art of philanthropy seems to have reached the heights and where they have never had the same level of government support for social causes and so there has not been a belief that the government should provide. Also there is a greater realism about altruism and personal benefit.

US/UK GIVING STATISTICS

A few figures will bring home this point.

The percentage of individual charitable giving to GDP is more than double in the US to the UK. In 2002 \$183.7 billion¹ was given by living individuals which represented 1.75%² of GDP. Using the same measure for the same year, the UK individual giving was £7.3 billion³; 0.76% of GDP.⁴

¹ The Chronicle of Philanthropy, Special Report, 26 June 2003

² IRS Figures (February 2004), see (Note 2)

³ The Sunday Times, Rich List. *How you can make donations to charity.* 18 April 2004

⁴ Computed from Inland Revenue figures (as assumed from footnote ³)

In the US 35%⁵ of employees give to charity through their payroll while in the UK only 2%⁶ of employees take advantage of payroll giving.

Why do the Americans give more?

1. For the historical reasons and because they have always done it.
2. But mainly because it makes them feel part of the community and this is reflected in the causes they give to – religion (local churches) gets 45%⁷ of donations; universities/colleges/alumni giving stands at 14%.⁸

Whereas in the UK:

13%⁹ goes to religion
3.7%¹⁰ to education.
17%¹¹ to medical research
14.4%¹² to children
10%¹³ to overseas development and
9.5%¹⁴ to animals

Which are all very worthwhile, but are not built on community.

Method of giving – planned or spontaneous

There is also a vast difference in how the Americans and Brits give. 77% of all collection methods measured in the 2004 UK Voluntary Sector Almanac, were spontaneous, loose change methods.¹⁵ In the US “planned giving is how they give it. 61% of the voluntary income of nonprofits comes through planned giving.¹⁶

PLANNED GIVING

⁵ Payroll Giving in Action, <http://www.payrollgiving.co.uk/employer.htm>

⁶ *Id.*

⁷ Internal figures generated by Institute for Philanthropy funded research (and/or review).

⁸ *Id.*

⁹ 2004 UK Voluntary Sector Almanac (table 33)

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See end NOTE 4

¹⁶ Internal figures generated by Institute for Philanthropy funded research (and/or review).

What is planned giving? Let us start with what it isn't. It is not putting your change in the tin coming out of the tube. But it could be a myriad of things – sitting down consciously as a family or an individual or a couple and saying “what do I want to give to charity this year” and then making donations.

Or making out a will with a charitable bequest.
But it could be having extensive meetings with a charity to discuss how to fund some particular thing (a soup kitchen, and academic post, a building)
Or it could be sitting down in front of your tax return on 30th December and rapidly working out what you are going to support before the end of the financial year when you can claim the tax benefit.

Tax incentives are often cited as the reason for greater US philanthropy. In a survey published in the *Chronicle of Philanthropy*, 54% of the richest US donors said they do give for the tax benefit.¹⁷

John Quelch, of Harvard Business School, is quoted as saying “As any good student of human nature knows, true altruism is extremely rare. But mix it with a little bit of self-interest and the chance to knock yourself down a tax bracket and you'd be amazed how generous the human soul can become.”¹⁸

Very often people say that our tax allowances are not as good as those in the USA. However the reforms to Gift Aid and Payroll Giving schemes in 2000 put in place generous tax incentives for gifts from income so that our incentives in the UK for charitable giving from income compare favourably with those in the USA. Gift Aid allows a full return of income tax paid by the donor of cash; as does payroll giving though there is a significant difference in that the charity receives part of the refund under Gift Aid while under payroll giving the donor receives the full refund.

In 2000 there was also introduced a very beneficial relief of the income tax allowance on gifts of quoted shares which is even better in the UK than the US as there is no limit was introduced.

See the *CHART OF DIFFERENCES BETWEEN UK AND US TAX INCENTIVES*

You will see that there are three main differences – first that with gifts of cash under Gift Aid, part of the benefit goes to the charity in the UK and in the US, the donor has the full tax benefit which is a considerable incentive to the donor. (2) I really think this is one reason why people do not think they are getting a tax break.

¹⁷ 2002 Harris Poll, *Chronicle of Philanthropy*

¹⁸ January, 2001, 34 *Vand. J. Transnat'l L.* 169, NOTE: U.K. Charity Law: Is it Creating a True Democracy of Giving?, James Randolph Michels

Secondly, in respect of gifts of capital and assets, we do not have an allowance similar to that on gifts of shares for unquoted shares and gifts of works of art. But there is hope - the Treasury initiated a Review by Sir Nicholas Goodison into the problem of getting more art into our museums and one of his recommendations is to give a tax allowance. This has been supported in the recent Report from the Task Force set up by the DfES to look into increasing voluntary giving to higher education.

SPLIT INTEREST TRUSTS

Thirdly, the main outstanding tax arrangement which would bring us into line with the USA would be to allow a donor to retain an interest or derive a benefit from his gift and still get a tax deduction.

Planned giving vehicles or split interest trusts as they are known whereby a donor can make a tax effective charitable gift while retaining a benefit during his lifetime are accepted by the IRS for tax deduction purposes. These have no connection whatsoever with the split investment trust.

Technically, split interest trusts have both charitable and non-charitable beneficiaries and that is why they are so popular in the US and that is why they incentivise giving and that is why we should have them in the UK. In 2001, the combined book value for split-interest trusts (in the USA) was \$111.2 billion, an increase of 18.4 percent from the previous year.¹⁹

There are three main types: (3)

I. POOLED INCOME FUND

The simplest is the Pooled Income Fund – this is a fund created by a charity into which a donor puts some money. The donor gets an income stream for his lifetime and perhaps the life of the wife and when he or she dies the remaining money goes to the charity.

There are all sorts of tax advantages around that that I am not going into but suffice to say it is easy for the donor because the charity runs it and all the donor does is make the donation and in return get cash annuity for life and the knowledge that anything left goes to charity.

But not every donor wants to have the funds managed by the charity so the US allows more sophisticated structures for the bigger donors who desire additional control.

¹⁹ Split-Interest Trust, 2001, IRS Statistics of Income Report

2. CHARITABLE REMAINDER TRUST

Probably the most popular structure in the US is what is called a Charitable Remainder Trust. It is very similar to a Pooled Income Fund in that a donation to a CRT creates a cash annuity for the donor generally for lifetime with remainder going to the charity of choice.

The differences are that by not pooling your investments with other peoples, the donor can:

- a) select own investment manager
- b) may select own trustees which could be himself
- c) retain flexibility to have multiple charities benefit at the end of the day and or change charities as the donors' interests change over their lifetime
- d) can also maintain total privacy and confidentiality. In fact, contrary to our view of publicity seeking American philanthropists, anonymity is frequently desired.

So these 2 structures (PIF and CRT) have significant tax benefits but more importantly they can be funded by illiquid assets to generate an income stream which will provide security for the future. Many people feel the philanthropic urge but the greatest inhibition is anxiety about their future needs. This way the future needs are protected. In fact the charitable remainder trust has become an increasingly popular form of insurance policy used by the middle wealthy. The policy can be funded either from cash or shares and at the end of the day it is a charity that benefits.

The charity benefits because when the donor enters these structures the charitable gift is locked in. The donor cannot change his mind as he could do with a Will.

To indicate how popular this is, the book value of American charitable remainder trusts in 2001 was in excess of 94 billion dollars (out of the \$112.2 billion total for split-interest trust) according to IRS statistics.²⁰

3. CHARITABLE LEAD TRUST

On the flip side there are other structures that benefit the charity first and the individual second. A Charitable Lead Trust is an example.

The charity gets an annuity for a set period of years and anything remaining goes usually to donor's family but to whomever the donor chooses.

²⁰ See NOTE 5

This tends to be less commonly used than the first two and it is used in estate planning context usually.

TAX CONSEQUENCES

I am not going to talk about the detail of the tax, but the basic point is that even if you set them up today and nothing goes to charity for 20 years, because you are locking it into charity, you actually get an income tax deduction today applicable to the current year's income. You cannot get an income tax deduction for the whole pot because you are going to benefit, but you will get a deduction related to the bit that is going to charity – based on an actuarial calculation.

Charles Collier, Senior Philanthropic Advisor to Harvard, told me that, “The most important factor for the donor is how to maximize their retirement income. The split interest trust appeals to self-interest.”²¹

EXAMPLES

Let me give you some examples of charitable remainder trusts. These were told to me by a lawyer friend who set up many of these trusts.

1. She was advising a wealthy couple with three children about their wills. One child was handicapped. They wanted to treat each child equally in their wills. But the child with the handicap had additional needs, so they created a CRT for his benefit with the remainder going to a charity which researched the illness the child had. The couple let the charity know that it would benefit and the charity was able to use this as an example to others.
2. Couple in California. Her sister was in need of some financial support to live more comfortably. Sister was in her 70s. So this couple set up a CRT with the annuity going to the sister for her life and then the capital would go to her old college at Claremont.
3. Fairly wealthy couple had a share holding which she had inherited when her father died in 1978 which at that time was worth \$50,000. By 1990s it had appreciated in value considerably and was now worth \$250,000. The couple viewed it as a nest egg but they were concerned about the CGT liability. They were both about 60 and were not comfortable with the idea of giving it away entirely to charity. So they put it into a charitable remainder trust. There was no CGT on the sale and they got a cash annuity for life. The stocks could increase in value inside the trust without any tax problem. When they both die the remainder would go to their alma mater.

²¹ Personal interview

Let me summarise why they did it:

1. Turned illiquid asset into a liquid one. They were funding their pension from shares rather than cash.
2. No tax cost - CGT
3. Income stream for rest of life
4. Tax deduction reduced tax charge in the year they gave it (and thereby increased their spendable income for that year).
5. Supported their alma mater – pleasure of lifetime giving and any rewards

The benefit to the charity is:

1. Locked in the gift
2. Because they knew they would get it they could do financial planning
3. Possibility of higher net gain because the money is already in a tax free vehicle
4. They can build on the established relationship with the donor and maybe get more.

It is also great for bankers as a way to attract clients. They can offer a flexible strategy for the client's financial and philanthropic planning and rather than the money going off to charity, it could remain under the management of the bank

LEGAL POSITION IN US AND UK

The IRS in the US accepts that it is not a single gift (as it would be regarded in the UK). They look at it as two separate gifts – one of the primary gift and one of the reversion. This is a legitimate analysis in law but it would not work for tax purposes in the UK. There are two related principles that underlie what is considered charitable giving in the UK and are reflected in tax policy. The first is that a donor should not retain an interest in or control over a gift. This prevents donors from setting up arrangements where an asset is technically gifted to a charity but the donor in practice retains control over its use. The second is that the donor should not derive any benefit from a gift. In the UK tax allowances have only been given if the gift is exclusively charitable. To allow the donor or any other non-charitable person/recipient to benefit through reserving a financial interest and get tax relief is alien to traditional financial principles.

However, with the need to fund universities, fund art for the nation there is a strong incentive for the government to review their policy especially as it will help individuals fund their own pensions.

USE THE TAX ALLOWANCES

But we already have tax allowances similar to those in the US which we need to use. It is up to the charities to promote tax effective giving. According to Inland Revenue figures, only 1 in 5 charities used Gift Aid.²² In 2003, £150million was received by charities through gifts of shares²³ but research done recently shows that fundraisers are not promoting share giving with their donors.²⁴

So in the 21st century let us take a leaf out of the American book USE the tax allowances to stimulate “the generosity of the human soul”. With changes already enacted since 1997 charitable giving through tax effective methods has jumped from £1.9billion to £2.3 billion according to Inland Revenue figures.²⁵ But our long term goal should be to match the US level of 1.75% of GDP. The equivalent level of charitable giving for Britain would be £17 billion²⁶ – that is, a further £10 billion (more than double) of giving available to all charitable causes at the moment. To achieve this we will have to encourage giving from capital rather than income and the introduction of the split interest trust.

NOTES

- (1) The top rate on earned income fell from 83% in the late 1970s to 40% by 1988. An additional investment income surcharge of up to 15% on very high investment income, leading to a maximum income tax rate of 98% was eliminated in 1984. The basic rate faced by most taxpayers fell from 33% in 1978-79 to 24% by 1996-97, and is now 22%.
- (2) The US gives at more than twice the rate of the UK in terms of % of GNP or equivalent GDP. “Giving USA” estimates that living individuals gave \$183.7 billion to US charities in 2002. The estimate of GDP for 2002 in the US is \$10,473.9 billion using the purchasing power parity measure). So individual charitable giving represents 1.75% of the GNP. The figures in the UK for 2002 prepared by NCVO/CAF (using the same measure) are £850 billion GDP and individual charitable giving being £7.3 billion. This produces a figure of 0.76% in the UK as against 1.75% in the US – more than double.

²² <http://www.givingcampaign.org.uk/>

²³ *Id.*

²⁴ *Id.*

²⁵ Inland Revenue figures

²⁶ Computed by means of Inland Revenue figures

- (3) In the USA some wealthy individuals donate until they have moved out of the higher tax band. The current UK arrangements for Gift Aid do not lend themselves well to respond to individuals who are motivated by such aims. Given that a small number of donors will contribute the vast majority of the value of an institution's gifts, it is important that the tax system is geared to maximising the amounts wealthy individuals donate.
- (4) Figures gathered by summation of "spontaneous" methods of giving, as expressed in Table 32 of the 2004 UK Voluntary Sector Almanac, and then division by the root sum of all possible options listed.
- (5) Developed by mathematical analysis of IRS Charitable Remainder Trusts Reports for 1998, 1999, 2000, and 2001; as reported in an internal Institute for Philanthropy memo (Split Interest Report).
- (6) Also –See Gretchen Clayton's Summary of US Charitable Giving Strategies

Remainder interest in personal residence

The donor transfers to a charity a remainder interest in his or her personal residence, retaining the right to use the property for the donor and spouse's life. Income tax relief is available in the year of donation on the value of the residence less the value of the retained interest. No capital or inheritance tax is due. On death, the charity has full ownership of the property and will usually sell it and use the proceeds in accordance with the donor's instructions.

Charitable Gift Annuity

The donor gifts assets (usually appreciated shares or property) to charity and receives an annuity.

- (7) What is the downside?
 - a. Abuse – Have had split interest trusts in US for 35 years – they have ironed out most of the abuse and can provide lessons in what to watch out for.
 - b. Poor management of the fund
 - c. Lack of promotion – financial advisers and charities need to be trained in how to set them up and how to explain them