The proposal in the last Budget to limit the amount of tax relief that individuals could claim on charitable donations was, thankfully, defeated after a vigorous campaign uniting charities, philanthropists and beneficiaries.

The Chancellor defended his U-turn with a dig at the supposed irrelevancy of philanthropy, claiming it was a necessary step in order to "fight the battles that are worth fighting". Other explanations involving less political spin interpreted the move as, at best a decision to defend charity income during the current cuts when demand is up and funding is down, and at worst yet another victory for powerful elites, although in this case those distributing rather than accumulating wealth.

But as the dust settles on the great charity tax debate of 2012, it’s clear that it was not just the impact of the proposal that deserved the attention of campaigners, but also the misguided assumptions on which the proposal was based.

Chief amongst these was the belief, apparently widespread amongst both ministers and civil servants in the Treasury, that the rich make charitable donations solely out of their annual income. Indeed, a briefing released by the Treasury in the week after the Budget bombshell to explain and defend the proposal, contained this example:

This cap will be set at 25 per cent of income (or £50,000, whichever is greater). That means an individual with an income of £4 million will still be able to give £1 million to charity.

Fundraisers know that the workings of their trade are a mystery to many, but the suggestion that any of the rare 7-figure+ donations received by UK charities (just 80 such gifts were made by individuals in 2009/10) come as a result of people giving away a quarter of their annual income shows stunning levels of philanthropic illiteracy.

People do not make mega-donations directly from their normal bank account. They make them by transferring money into and out of a personal charitable trust or foundation, which they set up as a result of once-in-a-lifetime wealth creation events, such as selling their business, gaining an inheritance or – less frequently – as a result of a large divorce settlement or lottery win.

Philanthropy remains an under-researched aspect of UK life, but the studies that do exist all show that more than half – and potentially almost all – rich donors have set
up such a vehicle for their giving. The reasons for establishing a foundation include it being a convenient and tax-efficient method for earmarking a large sum in advance of having decided which good causes are to benefit. Foundation giving is described by one philanthropist as ‘the Disneyland method’, meaning you pay once at the gate (by irrevocably committing a big sum) and then enjoy all the rides (or future donations) for ‘free’. Another donor, who committed £100 million immediately after selling his business for rather more than expected, told me his sudden wealth created ‘a moment and an opportunity’ to make one big charitable decision at that time, rather than having to re-visit his philanthropic inclinations every time he received a request for support: “we don’t have to think on a day-to-day basis whether or not to give some of our money away, because we’ve already made that decision”. There are also ‘obituary enhancing’ benefits including the potential to name the foundation after yourself and creating an institution that has a legal existence for as long as the capital remains.

Why does all this matter to policy makers? Because capping the sums eligible for tax relief would not be a serious deterrent to someone giving from income but it would remove the ‘moment and opportunity’ that some generous souls seize when they experience a windfall. The biggest donations of £1 million or more are almost never given directly to charities, but instead are parked in foundations and then the interest on the capital is distributed in smaller – but still very significant to the recipients – gifts, which did not raise alarm bells as being affected by the proposed cap.

As soon as George Osborne sat down after reading his ill-fated Budget I phoned a friend who works as a fundraiser for one of the UK’s biggest charities to ask how they could cope if their big donors were capped in this way. “Oh we’ll be fine,” she said, “we hardly ever get donations worth more than £20,000”. A few hours later she called back keen to sign up to the campaign against the cap, having spoken to a potential 5-figure donor who declared himself unable to make that gift if he couldn’t first put a 7-figure sum into his foundation.

Philanthropists are not like the rest of us, they don’t fish in their pocket for spare change to chuck in a collecting tin, or send cheques drawn on their current account or set up direct debits from their monthly pay cheque. The fact that no one at the Treasury seemed to know this does not bode well for future philanthropy policy making.

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