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Gift Aid and admin costs:
Risk of a double whammy for long term arts income

With the current focus on the campaign by major arts figures on the level of government funding for the arts, it is easy to overlook two other significant potential threats to income for arts organisations. They are perhaps a bit technical and even anorak-ish, and therefore less headline grabbing than delegations of recognisable arts leaders making a special case for the arts, but the threat is real. Please do read on!

i) "Administration" costs

Context

You will have seen the emphasis on the need for publicly funded organisations to reduce "administration" costs to no more than 6% of turnover. This includes the Arts Council but will also extend to recipients of Arts Council funding. The problem is that "fundraising" – including development office staff and promotional materials – is included in "administration". We therefore have the nonsensical spectacle of arts organisations being encouraged to adopt "US-style fundraising techniques" while being actively discouraged from investing in such techniques. It must be explained (internally as well as externally) that securing the financial future and hence sustainability of any arts organisation is an essential part of its mission. Now more than ever there must be a focus on this by the Boards of such organisations, and appropriate investment in the long term recruiting of donors, nurturing of relationships and stewardship that underpins and sustains private sector fundraising. A cost to income ratio of the order of 25% is well within current benchmarking experience. We know that too few trustee boards are willing to make that investment, but the case must be strongly made by those that understand the importance of this point that such investment is vital.

Indeed I would argue that the Arts Council should be challenging those it funds to report on what they are doing to bring in private sector funding!

But even if you do not want to go as far as that, the case needs to be made that private philanthropy takes time to nurture, and requires investment over the long term. This is investment in sustainability, not "unnecessary administration" costs.

ii) Gift Aid

Context

As you all know the administration of Gift Aid is very complex. There is a significant sum of unclaimed Gift Aid. Many small organisations do not "bother" to claim because they believe that cost and hassle of the efforts required to claim the Gift Aid outweighs the potential return to them, or (let's be honest) because they simply don't understand the opportunity. Recent research undertaken on behalf of HMRC by Sarah Smith of the University of Bristol shows that some two-thirds of higher rate tax payers do not claim the difference between the basic rate of tax claimed by the charity and the higher rate that they can claim back for themselves. BUT the higher rate tax is claimed in relation to some 80% of donations made by higher rate tax payers. In other words wealthy donors may not bother to claim for say a one-off £50 donation, but will certainly claim for larger donations.

The significant amount of unclaimed Gift Aid (estimates vary but it could be at least £500m) has allowed the government to resist calls for more funding or to reduce the burden of VAT on charities by pointing out that the sector should help itself by ensuring that more Gift Aid is claimed. (And of course all the more professionally run organisations do claim it.)

The government has recognised that the system is over-complex to administer (unlike in the US) and the Treasury has been "consulting" with the charity sector over the last couple of years or so. The trouble with this process is that the "sector" is very heterogeneous, with very different donor profiles and different interests. There are almost ideological differences between those who think (as I do) that the purpose of Gift Aid was and should be to incentivise donors along US lines, and those who believe that it is essentially a subsidy for charities that should have a redistributive effect, so that larger organisations in certain sectors who benefit "unfairly" from Gift Aid should effectively cross-subsidise smaller/less popular causes.

What is being proposed by many is the seductively simple solution of a composite tax rate, at 30% or 33%. The Treasury appears to like this, although many in the arts and education sectors are lobbying against this approach. The composite rate would decouple Gift Aid from tax paid by the individual donor and simply become a further subsidy which, as it is not controlled by the individual tax-payer, could in due course be changed (and lowered). Leaving aside all the issues of the psychology of giving and donor motivation, the threat to the arts sector if this were to happen is immediate and real. Dr Smith has analysed the likely impact of a composite rate of 30% and demonstrated that (because of the profile of donors to the arts) the arts would suffer disproportionately because of the redistributive effect. In other words tax reclaimed by the arts sector would decline (perhaps by up to 1%). Some sectors would gain significantly – animals is one. And of course it looks as though it would be cheaper to administer. There are some powerful advocates of the composite rate, including Cancer Research UK.

(There is also a risk to personal charitable trusts – and any similar structures - set up by higher rate tax payers that are funded by Gift Aid. You can see that the funding available for distribution to charities would reduce significantly, or the cost of ensuring that the trust has the same amount to give would increase. Instead of allocating £10,000 at a net cost of £6000 (adding the £4000 that would otherwise have been paid in tax at 40%), to achieve £10,000 for the charity will require a donation of £7000 (with the composite rate of 30%). A net donation of £6000 as before will generate about £8570. The difference will be even more marked with a higher tax rate of 50%)

The arts sector needs to fight this. (And it should be added that as the Dr Smith research was carried out for HMRC they and the Treasury are aware of the impact of a composite rate.) Some are making the case, including Arts and Business. And I understand that the Education sector is also lobbying on this point. The situation is changing quickly, and perhaps moving away from the idea of a composite rate, but far more people need to be taking a stand against the composite rate to ensure the right outcome.

My own view is that the general argument should focus on the need to retain the link to the individual tax payer. But for the arts sector there is, with the threat to investment in development discussed above a double whammy.

Theresa Lloyd
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