

# Budget 2008

## Implications for churches and Christian charities

March 2008

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## 1 Introduction

The new Chancellor, Alastair Darling, delivered his first Budget Statement on 12 March. There are a number of interesting developments of direct interest to the Charity Sector, mainly flowing from responses to the Gift Aid Consultation carried out by HM Treasury last year. Several of the proposals made in Stewardship's response to the Consultation have been picked up in the Budget announcements. A copy of our Consultation response can be viewed at:

[http://www.stewardship.org.uk/documents/Response\\_to\\_HM\\_Treasury-Gift\\_Aid\\_consultation.pdf](http://www.stewardship.org.uk/documents/Response_to_HM_Treasury-Gift_Aid_consultation.pdf)

Also of particular interest is the announcement of a new Consultation on the substantial donor legislation as a direct result of Stewardship's representations made to HM Revenue and Customs and HM Treasury last summer. Further details are given on this below.

In the text below and unless otherwise stated, where we refer to 'charity' or 'charities', this should be taken to apply equally to church or churches.

## 2 Gift Aid

### 2.1 Gift Aid transitional relief

In our 2007 Budget Briefing Paper, we explained that the announcement of a reduction of the basic rate of income tax to 20% from 6 April 2008, would result in an 11.4% fall in the value of tax reclaims under Gift Aid, all other things being equal.

For some churches and charities, this represents a significant fall in income.

However, Budget 2008 has announced a transitional relief supplement that will be paid to charities on Gift Aid donations for the *three tax years 2008/09 to 2010/11*. The impact of the relief is to restore the position for charities to that applying had the basic rate of tax not been changed. This measure will therefore give charities further time to adjust to the ultimate fall in relief from 2011/12 onwards.

#### 2.1.1 Manner of relief

For gift aid claims made *before* the date of Royal Assent to both the Finance Bill 2008 and Appropriation Bill 2008, the gift aid tax claim (at 20%) will be paid in the normal way but the transitional relief will be paid separately by HMRC *after Royal Assent*. There is no need to make a specific claim for the transitional relief. Royal Assent is expected to be given towards the end of July.

For claims made after Royal Assent, the transitional relief will be paid automatically along with the tax reclaimed, again without the need for a separate claim.

The rate of the transitional relief supplement will be 2 per cent and will be calculated by grossing up the net donation by the sum of the basic rate and the rate of supplement. The amount of relief due will be the difference between that figure and the amount of the donation grossed up at the basic rate of tax.

#### 2.1.2 Beware! There are special time limits.

Although the press announcements at the time of the Budget do not draw attention to this, if transitional relief is to be payable, the gift aid reclaim must be made in a much shorter time period (broadly, 2 years) than would otherwise be (broadly, 6 years). The effect, therefore, is to create different time limits for reclaim of the Gift Aid tax on the

one hand and the transitional relief on the other, notwithstanding that no separate claim for transitional relief is necessary.

Further detail on how the normal six year time limit for gift claims works can be found in our separate Briefing Paper: Gift Aid Claims and Declarations – Are You Too Late?, available by clicking onto:

[http://www.stewardship.org.uk/documents/Gift\\_Aid\\_Claims\\_2.pdf](http://www.stewardship.org.uk/documents/Gift_Aid_Claims_2.pdf)

However, for the transitional relief to be payable, the Gift Aid claim on form R68 must be made:

- for charitable trusts, within two years after the end of the *tax year* to which the claim relates; and
- for charitable companies, within two years from the end of the *accounting period* to which it relates.

### 2.1.3 Example of the relief

Mr. A who is a higher rate taxpayer gives his church £100 on the last day of each month throughout the calendar year 2008. He makes no other donations to the church before or after 2008.

The church also receives other gift aid donations during the tax year 6 April 2008 to 5 April 2009 of £18,000, received evenly through the year.

The church submit gift aid claims on Form R68 at the end of each calendar quarter.

Payments from HM Revenue & Customs are as follows:

#### **Claim on 30 June 2008:**

Net donations received from Mr. A: (April 30, May 31 and June 30)	£300	
Net donations from others: (£18,000 p.a. for 3 months)		<u>£4,500</u>
		£4,800
Gross up at (20% + 2% transitional relief)	£6,153	
Gross up at 20% basic rate of tax / Gift aid tax	<u>£6,000</u>	<u>£1,200</u>
Transitional relief	<u>£153</u>	
		<u>£6,000</u>

The gift aid tax of £1,200 is paid by HMRC on 14 July 2008. However, this is before Royal Assent and so the transitional relief of £153 is paid separately by HMRC on 11 August (without the need for a further claim by the church).

#### **Claim on 30 September 2008:**

The figures are exactly the same as for the 30 June claim. However, as the claim is after Royal Assent, HMRC will now repay the gift aid tax and the transitional relief (i.e. £1,353) together on the same date.

### Mr A's position as a higher rate taxpayer:

For gifts made after 5 April 2008, a higher rate taxpayer will now benefit from 20% personal tax relief (before 6 April 2007, this was 18%):

2007/08 - £300 gifts (January 08 to March 08) grossed up at 22%:	<u>£384.62</u>
Tax thereon at 40%	£153.85
Less basic rate relief to the charity at 22%	<u>£ 84.62</u>
Higher rate relief to Mr. A at 18% (40% less 22%)	<u>£ 69.23</u>

2008/09 - £900 gifts (April 08 to December 08) grossed up at 20%:	£ 1,125
Tax thereon at 40%	£ 450
Less basic rate relief to the charity at 20%	<u>£ 225</u>
Higher rate relief to Mr. A at 20% (40% less 20%)	<u>£ 225</u>

Mr A. is better off in 2008/09 compared to 2007/08, notwithstanding the transitional relief to the charity. Taking the charity and the higher rate taxpayer's tax positions together, there is an increase in overall tax relief.

#### 2.1.4 Payroll Giving

Payroll Giving is entirely unaffected by the transitional relief. It is now, therefore, more tax efficient to give through Gift Aid than through a payroll giving scheme. However, donors should also consider other factors, for example, administrative convenience and whether or not their employer operates a matched giving scheme before taking the decision to switch.

#### 2.1.5 Stewardship Sovereign Accounts

If you have a Stewardship Sovereign Account, either as a donor or as a beneficiary, we will continue to credit your account with the full 22% tax relief on gift aid donations immediately. In other words, Stewardship will fund the transitional relief from 6 April 2008 until it is received by us after Royal Assent.

#### **Action Points:**

- Charities will need to make separate claims for donations under gift aid received up to 5 April 2008 (at 22%) and those received from 6 April 2008 (at 20%). Underlying records will need to demonstrate which tax year a donation properly falls into and, if a computerised system for production of gift aid claims is used, users should ensure that the correct rate is applied to each donation.
- During the transitional period, the time limit for making gift aid claims is effectively reduced from 6 years to 2 years, if advantage is to be taken of the transitional relief.
- Charities with significant gift aid tax refunds should still begin preparations to deal with the ultimate decrease in available tax relief from 2011/12.

## 2.2 Gift Aid administration

The Budget announced a number of helpful changes to Gift Aid processes that are operated by HMRC. These are designed to reduce administrative and record keeping burdens:

### 2.2.1 Gift aid audits – error handling (1)

With immediate effect, where errors in an audit sample are found during a Gift Aid audit by HMRC, the charity will have the opportunity to correct those errors before HMRC calculate (extrapolate) the effect of the remaining error on the whole of the charity's records. For this purpose, 'errors' will generally be in relation to missing or incomplete Gift Aid Declarations.

#### Example

A church, with 100 people giving to it in broadly equal amounts within the Gift Aid Scheme, has claimed annual tax refunds which amount to £8,500. During a routine Gift Aid audit, HMRC found that 10 out of 100 Gift Aid Declarations were missing (a 10% error rate).

Prior to this change, HMRC would not allow the church to then locate or retrospectively obtain Declarations signed by donors to cover the missing documentation, on the grounds that the errors found at the audit were indicative of the 'normal' level of default. They would have calculated (extrapolated) an error of 10% x £8,500 (i.e. £850 for each year affected, up to six years) and may have charged interest and penalties on the sums to be recovered from the church.

However, if the church is now able to obtain Gift Aid Declarations from 6 of the 10 individuals (because, for example, the other 4 are either deceased or are not contactable), HMRC will now only 'extrapolate' a 4% error rate (this may be further mitigated by the revised practice set out in paragraph 2.2.2 below), reducing the tax and interest to be recovered from the church.

### 2.2.2 Gift aid audits – error handling (2)

With immediate effect, HMRC will operate a threshold error level of 4%, below which charities whose 'errors' in their claim are evaluated at less than £2,500 in each tax year (for charitable trusts) or accounting period (for charitable companies) will not be fully penalised for those errors in their Gift Aid claims.

The threshold error level will apply to the level of errors after any corrections referred to in paragraph 2.2.1 above.

### 2.2.3 Finer details:

Where either the **amount** or **level** of errors is small, HMRC will (to use a football analogy) introduce a 'yellow card' warning system. This will determine whether or not they will seek to recover tax from earlier years as well as the 'current' year and if so, the circumstances under which they will seek to recover tax from those earlier years. This is explained further in Table 1 below.

Yellow cards will be accompanied by advice on remedial action to be taken to prevent errors in record keeping in the future. If the remedial action is not heeded, the next time HMRC examine the claims of the charity, they will go back and recover tax on any earlier years that are still in date.

For larger errors HMRC will continue to seek recovery of past years' tax as previously.

Example 1 (please refer to Table 1 below)

A church makes a claim for gift aid in 2008/09 of £2,500 covering 500 individual donations. During a Gift Aid audit, HMRC take a sample of 50 donations and find 3 Declarations missing. This means that the church has an error rate of 6%. The church subsequently locates 2 of the Declarations (HMRC will give a reasonable period after the audit to locate these) which brings the corrected error rate down to 2%. Extrapolated across the whole Gift Aid Claim of 500 donations, this gives a tax value to the errors of £50 (2% of £2,500). No recovery is made either in the current or previous years.

Example 2 (please refer to Table 1 below)

A church makes a Gift Aid claim for 2008/09 of £50,000. This covers 500 individual donations. HMRC take a sample of 50 and find an error rate, after correction (Paragraph 2.2.1 above) of 4%, mostly due to the church not being able to provide Gift Aid Declarations. This represents a monetary tax total of £2,000 when 'extrapolated' through the whole claim of 500 donations. Applying the principles in the Table below, HMRC will seek recovery of tax in the current year and issue the church with a yellow card but will not seek recovery of any earlier years' tax. They will discuss with the charity what remedial action needs to be taken. If, at a subsequent audit, a similar problem is found, HMRC will then seek in year and prior years' tax recoveries.

2.2.4 Table 1

<b>Corrected error level</b>	<b>Amount of tax at stake</b>	<b>Action at Gift Aid Audit</b>
Less than 4%	Less than £100	No recovery in year of audit or earlier years. No card issued.
Less than 4%	Less than £500	Recovery in year but not earlier years. No card issued.
Less than 4%	<b>More</b> than £500 and less than £2,500	Recovery in year but not earlier years – 'yellow card' issued.
<b>More</b> than 4%	Less than £500	Recovery in year but not earlier years – 'yellow card' issued.
<b>More</b> than 4%	<b>More</b> than £500 and less than £2,500	Recovery in year and earlier years.

**Action Point:**

Notwithstanding these welcome administrative relaxations, charities should remain diligent in their record keeping, making sure that they have copies of *valid* Declarations for each donor, proper audit trails of donations received, etc.

### 2.2.5 Self-Certification

Charities sometimes employ external accountants to check that their Gift Aid claims are in order. They also have to go through routine audit inspections by HMRC Charities auditors.

HMRC will explore, with sector representatives, the possibility for charities to self-certify their Gift Aid claims where an external auditor is employed.

### 2.2.6 Gift Aid - 'aggregated' claims

With immediate effect, the Gift Aid claim process will allow smaller donations (of no more than £10<sup>1</sup>) to be aggregated on the R68 Claim Form, up to a total of £500. In other words, it will no longer be necessary to list all the individual donor names on the form.

Although it was not clear from the Budget announcements, this does not mean that aggregation cannot be used if the overall value of the aggregated donations exceeds £500 in any one claim. All that is required is that *on each line of the R68 Claim Form*, the aggregated donations do not exceed £500. In other words, if a claim is entirely made up of individual donations of under £10 but the total value of the donations claimed on is £1,200, the R68 can be completed on three lines: two of £500 and one of £200. This is therefore a particularly helpful measure for many churches who complete handwritten forms R68. There may be rather less benefit to churches using computer software to generate the R68 schedules.

Notwithstanding this optional relaxation, the charity must still retain each individual's gift aid declaration. By implication, therefore, there must be an adequate link in the charity's accounting records to be able to identify the individual donations that make up any particular aggregated claim.

Note also that this procedure will only apply to charities where collections have been made with a supporting Gift Aid Declaration. It will **not** apply to street collections where there is no Declaration, to the existing arrangements for sponsorship events, or to any other type of donation such as an additional entry fee to an attraction or to subscriptions.

### 2.2.7 Gift Aid – Record-keeping proposals

Currently charities need to keep Gift Aid Declarations for at least 6 years after the date that the last donation made under the Declaration is received. 'Enduring Declarations' (those that apply to all future donations by the individual to the charity) need to be kept indefinitely.

HMRC are therefore proposing to work with sector representatives to develop a framework for alternative records systems with a view to enabling the destruction of paper records for enduring declarations after 6 years.

### 2.2.8 Gift Aid – Improved Guidance

One of the key messages in Stewardship's response to HM Treasury's Gift Aid Consultation last year was the need for clear and accessible advice to charities on Gift Aid matters. We are, therefore, delighted that the Government has committed HMRC to a five month programme of improving their website 'Guidance on Gift Aid.' This development will focus on understanding customer needs and will include user testing with the sector before publication. Developments will include:

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<sup>1</sup> In discussion with HMRC Policy Staff, we understand that consideration is being given to increasing the individual donation limit in due course possibly to £20 or £25.

- A tailored 'news feed' facility to which charities can subscribe to receive charity related news and changes to guidance;
- A new toolkit of Gift Aid guidance, templates and other material available for new and existing charities. This will include guidance on how to get started with Gift Aid and how to use Gift Aid in different fundraising situations. This toolkit will be developed through discussions with sector representatives.

#### 2.2.9 What are your views? We want to hear from you...

Kevin Russell, Stewardship's Technical & Professional Services Director, has been invited by HMRC to consult with them on the design and implementation of the various Budget proposals in relation to charities. Therefore if you have any particular views on the measures proposed, please e-mail Kevin (<mailto:kevin.russell@stewardship.org.uk>) as soon as possible.

### 3 Substantial Donors

Regular readers of Stewardship publications will be aware of our significant concerns over the problems we identified as a result of the introduction of the 'Substantial Donor' legislation in the Finance Act 2006. These concerns are of particular relevance to churches and Christian charities but also have wider impact within the charity sector.

The problems are both broad and potentially very counter productive. Rather than repeat them here, readers can refer to the Representations that we made to HMRC and HM Treasury last Summer by clicking onto:

<http://www.stewardship.org.uk/documents/Gift%20Aid-%20substantial%20donor%20representations%20to%20HMRC%20-%20final.pdf>

Following the submission of our representations we, along with other sector representatives, met with members of HMRC's Technical and Policy teams last autumn to discuss our concerns in further detail. We were, therefore, delighted to see this work has resulted in a Budget announcement that the Government will be "... **consulting with charities on anti-avoidance legislation relating to substantial donors to simplify the system for charities and prevent innocent transactions from being caught.**"

A Public Consultation on draft legislative changes will be launched in the summer.

#### Action Points:

- Charities and their donors should make themselves aware of the issues both to protect themselves and to be informed ahead of the forthcoming Consultation.
- Be prepared to make informed responses to the Consultation citing examples of how you or your charity are affected by the legislation. Bearing in mind that the Consultation will be on draft legislation, Stewardship plan to provide briefing materials to assist charities in their responses.
- This is possibly a one-off opportunity to address the shortcomings of this legislation and, although Government Ministers are aware of the issues that we have raised, they want to know that concerns are widespread before acting. It is, therefore, important that the charity sector speaks out with a strong, unified voice in order to secure the necessary changes to the legislation

### 4 Personal allowances

Whilst comment to changes in personal allowances is strictly beyond the scope of this Briefing Paper, we feel that it is worth mentioning the impact of changes to the 'age related personal allowances'.

This is because those on a modest pension or modest other income in retirement, but who also give generously to their church or favourite charity under Gift Aid, may find that from 2008/09 they are no longer a taxpayer as a result of the significant increases to the level of personal allowances applicable to them.

The relevant changes are:

Age	2008/09 allowance	2007/08 allowance	Increase
65-74	£9,030	£7,550	£1,480
75+	£9,180	£7,690	£1,490

**Example:**

An individual (aged 68) with pension and other income of £9,000 in 2007/08 would pay (or suffer) tax of £145 (£1,450 at 10%) and would therefore be able to give approximately £10 per week to their church under gift aid (gift aid tax reclaimable by the church on net gifts of £520 being a fraction over £145). However, in 2008/09, the tax liability will fall to nil as a result of the significant increase in personal allowance. Consequently, the church should cease to reclaim gift aid on the £10 weekly donations.

**Action Point:**

Churches, in particular, and charities in general should consider checking with older donors if they will still be paying sufficient income tax to cover their gift aid donations. That said, it is likely that pensioners in this position will need help or advice in responding correctly!

## 5 VAT Measures

### 5.1 VAT Thresholds

The VAT registration threshold is increased from £64,000 to £67,000 with effect from 1 April 2008.

The new registration threshold will apply if:

- at the end of any month, the value of *“taxable supplies”* made in the past 12 months or less has exceeded £67,000; or
- at any time there are reasonable grounds for believing that the value of *“taxable supplies”* to be made in the next 30 days alone will exceed £67,000.

If, at the end of any month, a person’s *taxable turnover* in the past 12 months or less exceeds £67,000, but the authorities are satisfied that it will not exceed £65,000 in the next 12 months, registration will not be required.

**Action Point:**

- Most charities do not have taxable turnover because they do not make taxable supplies. For example, donation income is generally outside of the scope of VAT and service provision can be ‘non-business’. If in doubt, professional advice should be taken as failure to register for VAT at the right time can give rise to significant penalties.

## 5.2 VAT returns: correction of errors

For VAT accounting periods beginning on or after 1 July 2008, the size of net errors in previous returns that can be corrected on a current return, without separately notifying HM Revenue and Customs, will be significantly increased.

Errors on previous returns which may be corrected on the return for the period in which the errors are discovered will increase from £2,000 to the greater of £10,000 or 1% of net VAT turnover (Box 6 of the VAT return) for the return period, subject to an upper limit of £50,000.

## 5.3 Withdrawal of the Staff Hire Concession

In a Technical Note issued by HMRC, it was announced that a VAT staff hire concession will be withdrawn from 1 April 2009.

Under current arrangements, employment agencies are allowed to exclude the wages element of amounts paid for temporary workers from the value that they charge VAT on. Instead, they charge VAT only on their profit element. From 1 April 2009, VAT will become chargeable on the full amount. Charities that use the services of employment bureaux that use the existing concessionary arrangements will therefore be adversely affected, in as far as most charities cannot fully recover the VAT charged to them. This could represent a significant increase in costs for those charities.

### Action Point:

- Charities that use the services of employment bureaux should review their recruitment processes during the twelve months leading up to the withdrawal of the concession. Where the increased VAT cost is likely to be significant, consideration should be given to costs v. benefit of a change to direct recruitment practices.

## 5.4 Window of opportunity (until 31 March 2009) to reclaim past VAT overpaid

On 1 May 1997, a three year time limit was introduced that prevented taxpayers reclaiming VAT overpaid more than three years previously. In January 2008, the House of Lords held in the 'Condé Nast' case that, because the Government did not allow for a transitional period when the three-year cap was first introduced, it was effectively illegal in respect of repayment claims that existed at that point.

Consequently, where a charity was registered for VAT at any time between the introduction of VAT on 1 April 1973 and 1 May 1997, it may now claim a repayment for any output VAT over-declared on any input VAT that was under-claimed.

Legislation will allow claims to be made for a transitional period up until 31 March 2009 for:

- Input tax (on expenditure) previously unclaimed in accounting periods ending between 1 April 1973 and 1 May 1997;
- Repayment of over declared output tax (on sales turnover) to be made for accounting periods ending between 1 April 1973 and 4 December 1996.

Changes will also be made to ensure that HMRC can recover amounts paid out where it is later discovered that a repayment was made in error.

### Action Point:

- Charities that may be affected should seek suitable professional advice on the merits of their claim. Areas of particular opportunity include back recovery of VAT on costs incurred on fundraising for unrestricted funds (following the HMRC

defeat in the Children's Society case in 2005) and VAT costs on investment management or advisory fees (following recent VAT decisions). Not only can claims date back as far as 1973, but interest can also be claimed as part of the total reclaim.

## 6 National Minimum Wage

New rates of National Minimum Wage will apply from October 2008. The adult rate will increase to £5.73 per hour, the development rate for 18-21 year olds will increase to £4.77, and the youth rate for 16-17 year olds will increase to £3.53.

Readers are reminded that there can be no opt out from NMW by workers that are entitled to it. This can cause particular problems for volunteers who, if paid, must be paid at least NMW rates for every hour worked.

### Action Point:

Charities with any workers or volunteers entitled to the National Minimum Wage should ensure that they understand the rules and their responsibilities under the Act in order to avoid exposure to liability for back payments and enforcement action by HMRC.

## 7 Capital Gains Tax

The announcement of the controversial flat rate charge to capital gains tax (CGT) of 18% and the introduction of an 'Entrepreneurs Relief' (equating to a 10% rate) with effect from 6 April 2008 means that, for some taxpayers, a gift of qualifying shares or property to charity now has correspondingly less 'benefit'. However, such an analysis is a little spurious and academic, since a gift to charity of assets of this type will remain exempt from CGT in exactly the same way as they would have been prior to 6 April 2008.

However, where an asset chargeable to CGT is sold after 5 April 2008, whilst the amount of tax payable could potentially fall (this depends on the circumstances of each case as taper relief and indexation relief have been withdrawn), it may also mean that CGT otherwise available to cover gift aid donations to charity may also have decreased.

### Action Point:

- In this period of fundamental change to the capital gains tax regime, any persons making gift aid payments to charity out of capital gains should ensure that they understand the new form of calculation to ensure that they do not 'gift aid' beyond their current tax capacity to do so.

## 8 Tax Credits: Increase in withdrawal rates

The increase in the tax credit withdrawal rates was tucked away in the 2007 Budget technical documents but is effective from April 2008.

Entitlement to tax credits is means tested. Above certain thresholds of income, the amount of tax credits awarded are progressively withdrawn as income of the claimant increases. This reduction in award is calculated according to a tax credit withdrawal rate. The first and second withdrawal rates are to be increased to 39% and 6.67% from April 2008.

This means that claimants with a reasonable income such that they are subject to withdrawal of credits will see a reduction in their entitlement. However, the income that is assessed for these purposes is taken into account **after deduction of the gross amount of gift aid payments to charity**. As a result, the cost to the donor in these

circumstances of £1 given to charity will reduce as their donation will 'buy back' some of the credits that would otherwise have been withdrawn.

**Action Point:**

- Donors may wish to review their level of giving under gift aid. This is particularly so for donors whose income for tax credit purposes is near the tax credit thresholds.

## 9 Tax returns - Self funded Christian Workers

A further announcement made last year, which is repeated here, affects personal income tax returns. Christian workers who raise their own support and are liable to UK tax may be required to submit self assessment tax returns. Until 2006/07, returns were required to be filed by 31 January after the end of the tax year to which the return related.

However, the deadline for filing returns changes for 2007-08 and subsequent years. There are now two alternative filing dates. For paper returns, the deadline is brought forward to 31 October (for tax year 2007-08 that will be 31 October 2008). For taxpayers filing paper returns who want the Revenue to calculate their tax liability for them, the previous cut off date of 30 September also moves to 31 October.

However, for returns *filed online*, the deadline will remain at 31 January (for tax year 2007-08 that will be 31 January 2009). A calculation of tax liability is automatically provided when a return is filed online.

**Action Point:**

- Taxpayers should be aware of the changing deadlines so as not to face unwelcome penalties, default surcharge and interest charges. Online filing requires users to register with the Government Gateway (information at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)). Online filers should build in time for this process ahead of filing their return.