



CHARITIES UPDATE – 4th DECEMBER 2007

Questions and Answers

CONTENTS

Page(s)

Q1.

We are a religious charity with substantial assets but our membership is gradually dwindling in numbers. We are currently in a position which allows us to make our presence known in the community and are concerned that in future we will have to demonstrate a public benefit. Is it likely that we will have to do this and what can a charity in our position do?

1

Q2.

We are a service providing charity – we run a school - and gather that the rules under new SORP require us to set out our trustees report in a new way. How should we do this and will it help us to explain the real public benefit we provide in the course of our work?

2

Q3.

We are a charity which manages and has close links with another charity. In order to ease the administrative burden we would like to merge the two charities. In the past this has not been possible due to legal complexities; are there any provisions in the new Act that will allow us to do this?

3

Q4.

As a charity, do we have to be concerned with the recent changes in company law?

4-6

Q5.

Has the new charities legislation introduced any new measures in regard to trustees' duties and in particular has it provided greater protection against trustee liability?

7-8

Q6.

Our convent has a valuable collection of art which we have only valued in the accounts at an estimated original cost value, depreciated now to a nominal £1. Under the new SORP, it is understood that Heritage Assets have to be valued on a collection basis and that this can be avoided completely if a valuation is 'impracticable'. What should we do?

9

Q7.

CIOs have been heard about - what are they and what benefits do they offer?

10

CONTENTS (cont.)

Q8.

We allow married couples to hold wedding receptions and anniversary parties in our church hall. We have been asked if the premises can be used by a couple for a reception after their civil partnership ceremony. Our religious ethos does not accept homosexual relationships. Can we refuse the booking? Do you have views on how to deal with the possible exclusion of some religious charities from local authority contracts, where their ethos on civil partnerships is inconsistent with anti discrimination laws?"

11-12

Q9.

Is a UK registered charity permitted (legally) to have its HQ (if not its registered office) outside the UK, in another EU country, or even Switzerland? If so what are the implications (legal and financial)?

13

Q10.

We are worried about some changes in the tax rules for charities which could result in a tax liability if we incur non-charitable expenditure. How can this be as I though charities were exempt from tax and what is non-charitable expenditure?

14

Q11.

We are arranging a fundraising event over the Christmas period using a professional fundraiser. Are there any issues we need to worry about when using professional fundraisers?

15

- 1. We are a religious charity with substantial assets but our membership is gradually dwindling in numbers. We are currently in a position which allows us to make our presence known in the community and are concerned that in future we will have to demonstrate a public benefit. Is it likely that we will have to do this and what can a charity in our position do?***

Answer

As of now charities involved in relieving poverty, advancing education and advancing religion are presumed to benefit the public. However, the Charities Act 2006 includes a requirement that all charities must prove public benefit. The relevant provisions of the Act have not come into force yet but are expected to do so in the first quarter of 2008. The Act does not contain a definition of public benefit and the problem of providing guidance for charities on the issue has been left with the Charity Commission. The Commission published a consultation paper on public benefit some time ago and received a large number of responses, many from religious charities. The Commission is now trying to finalise its guidance which is proving difficult in light of the issues involved and the responses to the consultation.

The short answer to the question is, therefore, that a charity in these circumstances will need to demonstrate public benefit once the Act is in force. Now is a good moment to prepare for the new law by undertaking an audit of what the charity actually does which could be said to be of public benefit. Each member of the charity could be asked to fill in a questionnaire to this end. The likelihood is that the charity will then find that it does actually fulfil the public benefit test. The important point is not to panic about being able to demonstrate such benefit. The mere fact of dwindling numbers is not a problem in itself. If such a situation does lead to a perception that public benefit is limited then consideration should be given to taking on other activities or possibly transferring assets to another charity. The important point to note is that public benefit will be considered in a proportionate way to a charity's size.

In its consultation the Charity Commission suggested that it would expect charities below the audit threshold to include a short statement about public benefit in their annual report. Charities above the audit threshold are likely to have to go into much more detail to demonstrate the public benefit objectively.

For religious charities there is a particular issue connected with demonstrating public benefit. Such charities should not just be looking at 'works of charity' which are objectively assessable in terms of public benefit. There is also spiritual benefit provided by such charities so you should be considering this and how to describe what benefit your charity can be said to have in terms of spirituality.

Charities will have to tackle the issue of public benefit and cannot regard voluntary de-registration as an option!

2. ***We are a service providing charity – we run a school - and gather that the rules under new SORP require us to set out our trustees report in a new way. How should we do this and will it help us to explain the real public benefit we provide in the course of our work?***

Answer

There is some new guidance from the corporate sector on how trustees should present their report which should help to address public benefit issues.

What are we trying to measure?

Outputs – the activities, services and products provided to users.

They show the volume of work undertaken, representing the direct products of the charity arising from its activities.

Outcomes – the changes, benefits, learning or other effects that happen as a result of the charity's services or activities.

Impact – the broad, longer-term effects of the charity's work.

What difference does the charity make?

- 3. *We are a charity which manages and has close links with another charity. In order to ease the administrative burden we would like to merge the two charities. In the past this has not been possible due to legal complexities; are there any provisions in the new Act that will allow us to do this?***

Answer

The Charities Act 2006 ('the Act') has introduced some measures to facilitate mergers and ensure that they occur smoothly. Merging any organisation is generally considered to be complex and involve a lot of cost and effort. For charities in particular, there is also the concern that legacies might be lost as a consequence of the merger or the change in name of the charity. In the past this was dealt with by allowing the transferor charity to exist as a shell charity just to continue receiving legacies but this was often an administrative burden and could lead to confusion arising.

The Act introduces a 'Register of Mergers' and a document known as a 'Vesting Declaration'. The document automatically vests property on changes of trustees. The document relates to registered land and avoids the need for numerous transfer documents. If the document is used, the transfer must still be noted at Land Registry. The documents do not apply to certain other assets such as stocks, shares and annuities.

If the Vesting Declaration is used then the merged charity must register on the 'Register of Mergers'. If such a document is not used then registration is voluntary.

If the merger is registered on the Register of Mergers, any legacies or gifts to the merged charities do not fail. This avoids the need to maintain shell charities purely for the acceptance of legacies and gifts.

Other measures introduced by the Act which will assist and facilitate mergers include the possibility to make amendments to governing documents and the ability to spend capital in certain circumstances.

4. As a charity, do we have to be concerned with the recent changes in company law?

Answer

It depends what is meant by concerned. Worried or disturbed - no, but are there implications and things to think about - yes. In this note reference is only talking about only charitable companies limited by guarantee, not trusts, nor unincorporated associations.

What are the changes - quite a few. The Act runs to exactly 1,300 sections – the longest ever passed by Parliament.

First there is a category over which there is no need for concern – indeed the changes might even help a little to save money.

Examples in this category are:-

- the shortening of periods of notice for meetings,
- the ability to use electronic communications more widely than now (for notices and supplying accounts to members)

both of which are in force since October 2007,

also to come from April 2008 in this category:-

- that a company secretary will no longer be needed, and
- documents can be signed off by a single director.

As time passes some charities will surely find the changes helpful and make adjustments to their articles where necessary to allow them to use the provisions.

Secondly, there is the category that might be said to be a bit of nuisance:-

- All companies now have to make sure that the company name, registered office address, registered number and the fact that it is a limited company (usually done now on stationery by saying “Company limited by guarantee no xxxx) is shown on its letters as now, but also on any orders placed for goods or services and on its website – already in force since January of this year.

- Sending all members proxy forms for Annual and Extraordinary General Meetings (in force since October 2007) is another in this category. It’s applicable whether the articles provide for proxies or not. The proxy need not be another member – which can of course have possible implications.

- Then in just over two years’ time (its introduction has recently been deferred to October 2009), we can start getting used to a different form of memorandum and articles – the idea being that the memorandum is to be part of the articles.

- Finally there are the changes about directors – just over a 100 sections on this. Only 7 of these will be mentioned – the 7 statutory duties of directors. 4 of these sections were brought into force in October last year and may bother some director/trustees, though so far the impact has been pretty muted.

a. a duty to act within the company's powers (sec 171). Most charitable companies have a catch all at the end of the list of powers in their objects clauses that say they can "do all such other lawful things as are necessary for the achievement of the objects or are incidental or conducive thereto". Charity Trustees/directors have for some time been reminded by the Commission & other advisors of the importance of acting in the interests of the charity and not acting outside its powers, so there is nothing new here for Charity Trustee/directors.

b. there is a new duty to promote **the success** of the company for the benefit of its members as a whole (sec 172). As the members of charitable companies are not supposed to benefit we would have expected to see an exception for charities. But if we go with the spirit of the section, the question arises for charities on how to measure success – not set out.

The Act does set out 6 factors to consider when making decisions contributing to the success of a company:-

- its long term consequences,
- the interests of the employees,
- the impact on suppliers, customers and others,
- the impact on the community and the environment,
- the effect on its reputation for high standards of business conduct and the need to act fairly between its members
- the need to act fairly between its members – irrelevant for charities.

These suggest that success should not be measured purely in financial terms. These are really ethical criteria, and trustees are going to have to decide where to strike a balance in applying them. We have some way to go in seeing how this develops for charities, (as it may change the relationship between the trustees and the CEO and other senior officials of a charity). (Some charity trustees are not involved in the day to day management decisions – they are the people who have the control of the administration and management of the charity – but they could possibly set a policy on this.)

c. (section 173) a duty to exercise independent judgment. This should not be a problem in charitable companies, as trustees are under such an obligation already.

d. (section 174) the duty to exercise reasonable care, skill and diligence. This is further defined, in a way that is difficult to explain, but which means that the minimum to be expected of a trustee/director is that he has the skill and knowledge that is reasonably expected of a trustee/director. If a person actually has more than this minimum skill and knowledge, then he cannot get away with making a stupid decision, by saying that even though

he was very skilful and knowledgeable, he should be treated as having a lesser amount of knowledge.

These are treated as fiduciary duties to the members and breach gives rise to civil claims for damages, rather than criminal penalties, though who would enforce them in the case of a charity is unclear.

The other three duties are to be brought in at a date to be announced – but are not really worrisome either in the context of charities, as they relate to conflicts of interest (already something charity trustees must avoid), the receipt of benefits from third parties (almost certainly irrelevant for charity trustees) and the requirement to declare interests in proposed transactions (already covered by other Charities Act requirements.)

So – yes - there is quite a bit to think about as part of ongoing governance review processes, but nothing to be disturbed about.

5. *Has the new charities legislation introduced any new measures in regard to trustees' duties and in particular has it provided greater protection against trustee liability?*

Answer

The role of the trustee remains a voluntary one and the Charities Act 2006 ('the Act') recognises this. The duties owed by trustees remain the same. However, some protective measures have been introduced which offer trustees might comfort. These include the ability to purchase 'Trustee Indemnity Insurance', a waiver for disqualification and equitable relief measures.

Trustee indemnity insurance covers individual trustees against personal liability in respect of claims for: breach of trust and breach of duty, and any negligence or default in their capacity as director of a corporate charity.

The indemnity insurance does not protect the charity against third party claims and does not relieve the trustees of a trust or an unincorporated charity from personal liability in the event the charity cannot pay its debts.

Unless there is an express provision in the charity's governing document, expressly prohibiting the purchase of trustee indemnity insurance, the charity can pay for the premiums. In the past the consent of the Charity Commission had to be obtained in order to do this. Even if there is an express prohibition, if an approach is made to the Charity Commission, it is likely that the Commission will agree to a Scheme allowing the purchase of such insurance.

In addition to checking the governing documents, the trustees must be confident that the purchase of the indemnity insurance is in the best interests of the charity and that the cost of purchase is reasonable. In addition they have a duty to obtain independent professional advice before doing so.

The policy should include a clause that it does not cover liability in respect of: fines imposed in criminal proceedings or penalties from regulatory action; a criminal proceeding in which a trustee is convicted of fraud, dishonesty or wilful and reckless misconduct or conduct a trustee knew was not in the best interests of the charity.

The Act also introduces a waiver from disqualification as a trustee. Under section 72 of the Charities Act 1993, there exist various scenarios in which an individual will be disqualified from acting as a trustee. The Commission can now waive disqualification after 5 years of disqualification.

In the past, when a trustee had made an honest or reasonable mistake the Charity Commission was unable to grant relief and only the Courts could do this. The charity would have to go through a process of investigation and possibly involve the Courts to get to the bottom of the matter. This might involve obtaining consent from the Charity Commission to enter into such proceedings and could lead to matters becoming fairly complicated

and costly. The Act has introduced a new power for the Charity Commission to be able to grant relief when a trustee or an auditor has made an honest or reasonable mistake which has led to a breach of trust.

6. ***Our convent has a valuable collection of art which we have only valued in the accounts at an estimated original cost value, depreciated now to a nominal £1. Under the new SORP, it is understood that Heritage Assets have to be valued on a collection basis and that this can be avoided completely if a valuation is 'impracticable'. What should we do?***

Answer

What are Heritage Assets?

Heritage assets are assets of historical, artistic or scientific importance that are held to advance preservation, conservation and educational objectives of the charities through public access contribute to the nation's culture and education either at a national or local level. Such assets are central to the achievement of the purposes of such charities and include the land, buildings, structures, collections, exhibits or artefacts they are preserved or conserved and are central to the educational objectives of such charities.

They can be excluded from the Balance Sheet if:

- (a) reliable cost information is not available and conventional valuation approaches lack sufficient reliability; or
- (b) significant costs are involved in the reconstruction or analysis of past accounting records or in valuation which are onerous compared with the additional benefit derived by users of the accounts in assessing the trustees' stewardship of the assets.

7. CIOs have been heard about - what are they and what benefits do they offer?

Answer

The CIO is the Charitable Incorporated Organisation and is an entirely new legal format for charities which is being brought into existence by the Charities Act 2006 and has been under discussion since the early 1990s. The relevant provisions in the Act are likely to come into effect in the middle of 2008 but the timetable could slip. Due to the fact that this is a new concept, it is proving difficult for the government to make sure that all current laws which might have an impact on CIOs are taken into account in drawing up relevant regulations for their operation. Much of the rules concerning CIOs will be included in secondary legislation. The government and Charity Commission are working on a consultation paper which will include model forms of constitution for CIOs. The main benefits of a CIO are that it will have limited liability to third parties and it will not be subject to company law. At the moment, any charity wanting to have limited liability must establish itself as a company limited by guarantee which means the trustees must have regard to both charity law and company law. This can be burdensome. It seems likely that there will be two permitted formats for a CIO – one which involves both members and trustees and one with a board of trustees alone. Further details will become clear once the government/Charity Commission consultation is published. The Charities Act 2006 provides a mechanism for charitable companies to convert into CIOs. It seems likely that the CIO will not be suitable for all situations. For example, it may well not fit well into a legal structure where there is a main charity and a network of subsidiary branches.

- 8. We allow married couples to hold wedding receptions and anniversary parties in our church hall. We have been asked if the premises can be used by a couple for a reception after their civil partnership ceremony. Our religious ethos does not accept homosexual relationships. Can we refuse the booking? Do you have views on how to deal with the possible exclusion of some religious charities from local authority contracts, where their ethos on civil partnerships is inconsistent with anti discrimination laws?"**

Answer

There was quite a debate amongst religious leaders in many faiths over what are known as the Sexual Orientation Regulations 2007 – before they were recently introduced – and to an extent the lobbying worked because an exception for religious organisations was made (in Reg 14).

The exception is drawn in a rather complicated manner, but can be summarised as follows:-

If it is necessary to discriminate on grounds of sexual orientation either:

- to comply with the doctrine of the organisation or
- to avoid conflicting with the strongly held religious convictions of a significant number of the religion's followers,

then the organisation can do so. Thus if these conditions apply, the church could say no to the hiring request.

Applying this to real situations will not be easy and cases will in due course arise on it. The claim is for breach of statutory duty with the damages based (it is thought) on "injury to feelings". One could be looking at £500 - £5K for one-off cases and may be up to £15K for ongoing cases.

Then there's the wider question raised of faith based charities being paid to provide services for Local Authorities and Social Services.

For many years charities in receipt of local authority funding have had to set out in their applications for grants their policies on equality and diversity, and sometimes to affirm their adherence to such policies in the contractual documents – not a problem by and large on race, disability, gender, religion or age discrimination – but often sexual orientation is now included.

The Sexual Orientation Regulations (at Reg 18) allow for discrimination on grounds of sexual orientation in the supply of "benefits" if to do so would be contrary to a charity's constitution. "Benefits" is not defined and is not referred to in the clause relating to goods, facilities and services. So the extent of this exception is unclear. It is improbable that charities would wish now to change their constitutions to take advantage of the clause.

There is no answer for charities who have strong convictions on this. We have come across a local authority allowing the clause indicating

adherence to a full equality policy to be qualified to the effect that compliance could be refused where difficulty or embarrassment would be caused to the charity concerned, but do not believe this is widespread – which accords with the spirit of the exception. It is certainly worth raising concerns when agreeing the form of contracts and establishing what would happen if some qualification of the requirement were to be sought – if this is thought to be of sufficient practical importance.

The only comfort is that it does not seem to be a problem in practice very often. Ultimately of course a charity might be put into a position of having to decide the least bad course – either to stop taking the Local Authority funding and possibly have to curtail or terminate their work, or continuing their work with their principles compromised.

- 9. *Is a UK registered charity permitted (legally) to have its HQ (if not its registered office) outside the UK, in another EU country, or even Switzerland? If so what are the implications (legal and financial)?***

Answer

This question raises some complex issues so a brief answer only is offered here. In broad terms, there is no reason why a charity's HQ may not be in a jurisdiction other than England and Wales, whether Switzerland or elsewhere. There will be different considerations depending on whether the charity is constituted as a Trust or a company. With a Trust, the Charity Commission takes the view that English law requires the majority of trustees to be resident in this jurisdiction. It could be difficult, although not impossible, to have the HQ of a Trust outside England and Wales whilst the majority of trustees were resident here. With a charitable company it must have its registered office in this jurisdiction. However, the registered office is often only an official address for correspondence. It does not have to be the company's HQ. There are no legal restrictions on the residency of company directors. If the HQ were to be overseas then consideration would need to be given to the establishment of a legal structure in that jurisdiction. Also, a review of that country's charity law would be necessary which may not always be straightforward. As regards finance, the main consideration would be that money could be transferred from England if it was to be applied for charitable purposes recognised by English law. Her Majesty's Revenue & Customs has recently indicated that it will be looking more closely at overseas payments by English charities. Finally, tax laws might be relevant to this situation. There is a move in the European Union to harmonise some tax laws relating to charities. Switzerland has recently signed up to a large number of treaties aligning itself with European laws so might be expected to follow suit if the EU does harmonise laws relating to charity tax or other issues.

- 10. We are worried about some changes in the tax rules for charities which could result in a tax liability if we incur non-charitable expenditure. How can this be as I thought charities were exempt from tax and what is non-charitable expenditure?**

Answer

What is 'Non-Charitable Expenditure?'

- Expenditure which is not incurred for charitable purposes only.
- Any payments to an overseas body where the charity has not taken reasonable steps to ensure the payment will be applied for charitable purposes.
- Any investments and loans made by the charity which are not qualifying investments and loans.
- Amounts treated as non-charitable expenditure as a result of transactions with substantial donors which fail the tests in S506A ICTA 88.
- Trading losses which arise from non-primary purpose trading.

If a charity does incur this type of expenditure it could be deemed to be taxable by HMRC so further guidance should be sought.

New rules effective for chargeable periods starting on or after 22 March 2006 and can be carried back 5 years!

11. We are arranging a fundraising event over the Christmas period using a professional fundraiser. Are there any issues we need to worry about when using professional fundraisers?

Answer:

When entering into an arrangement with a professional fundraiser the trustees of a charity should take care as to the type of arrangement they are getting involved with. In particular they should look to protect the good name of the charity. Some points to look out for include:

The event

- Clearly publicising what the appeal is for.
- Stating what the funds will be used for; whether they are for a specific project or for the general purposes of the charity.
- What will happen to any surplus funds?
- Consider opening a separate bank account for appeal funds.
- Set out an end date for the appeal.

Agreements with fundraisers:

- A written agreement (which is in a prescribed form) – consider obtaining legal advice.
- A statement to be given to inform donors what proportion of the funds will go towards the professional fundraiser's costs.
- Details of when and how the funds will be transferred to the charity.
- Consider if the fundraiser is reputable e.g. obtain references for them.

Other factors:

- The charity might like to consider if the funds could be obtained in another way e.g. by way of grants from other charities or public bodies
- Would it be possible to work with another charity to meet the needs of the particular projects or groups of beneficiaries the charity wished to benefit?

The Charities Act 2006 ('the Act')

The Act, aims to introduce amendments to the area of fundraising; particularly in relation to fundraising statements and collaborations with professional fundraisers. There will also be amendments introduced in relation to the licensing for door to door collections and street collections. Some of these amendments were due to come in to force in November 2007 but the fundraising sector have made representations to Government asking for the amendments to be postponed.

