A CHARITABLE ACT?

Beyond the Charities Bill

by Robert Porter

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SUMMARY

- **The Government's Charities Bill is a missed opportunity**. It focuses mainly on technical adjustments to charity law, ignoring a number of strategic reforms that might benefit the charitable sector.

- The Bill has a number of shortcomings. These include:

  1. **Failure fully to think through the implications of the adoption of a list of charitable purposes**

  o Although the list adopted by the Bill will be non-exclusive, attempts to over-codify what purposes may be charitable may encourage the Commission and others to regard the list as "quasi-exclusive".

  o Attempts to over-define charitable purposes are fraught with difficulty. Prominent examples include the definitions of "religion" and "sport".

  2. **Failure fully to think through the implications of the abolition of the public benefit presumption**

     - The concordat reached between the Home Office and the Charity Commission about public benefit creates an important opportunity for charities that charge fees to embrace change and address concerns about wider access in the public benefit context.

     - The concordat and any subsequent guidance issued by the Charity Commission may not accurately reflect the law and creates uncertainty, especially in the light of Government's latest assertions that it comprises only a "good partial basis" for an explanation of public benefit.

- The concordat paradoxically threatens to punish the least well-off charging charities, since they will be the ones least able to accommodate and pay for wider access.

- The repercussions for organisations that may be removed from the register as a result of the abolition of the public benefit presumption have not been fully addressed.

- The way in which the Charity Commission intends to conduct ongoing public character checks may not be reasonable, fair or proportionate.

3. Failure fully to think through the implications of the enhanced role of the Charity Commission

- The role of the Charity Commission is greatly expanded in the Bill. It is not clear that the Bill's final Regulatory Impact Assessment has adequately dealt with this. The Commission must be adequately funded and resourced to enable it properly to fulfil its enhanced responsibilities under the Bill.

- The Commission appears not to be sufficiently accountable – for example, there is no guarantee that the costs of bringing a case in the Charity Appeal Tribunal will not be prohibitive to some; and appeals from the Charity Appeal Tribunal are only on a point of law. There are also issues around the recovery of costs in relation to a Charity Appeal Tribunal hearing and access to financial assistance for less well-off appellants. Accountability to the charitable sector generally remains inadequate.

- The Commission has a dual role of regulator and advisor – without a statutory obligation to put a Chinese wall between these functions.

4. The potential for excessive regulation

- The Bill's reserve power to regulate public fundraising should be subject to Parliament's affirmative procedure, without which there is the potential for knee-jerk regulation that ignores existing safeguards. This power to wrap charities' fundraising in red tape should be resisted unless essential to safeguard the sector's reputation.

5. Failure to address the VAT burden on charities

- Charities pay out over £460 million annually in irrecoverable VAT. This slashes the value of the benefit they derive from Gift Aid by over 40%.

- Government has failed to address the EU law restrictions on the ability of charities to recover otherwise irrecoverable VAT, or to implement a "reimbursement" scheme to mitigate irrecoverable VAT's effects.

6. Failure to assist charities in public service delivery

- Government has expressed a wish that charities should do more in the delivery of public services. The Bill does little to facilitate this.

- Major failings include failure to prevent unfair contract terms, to promote fair remuneration, to clarify the ability of trustees to accept contracts that do not offer full cost recovery, to make professional representation on charity boards easier and to manage the issue of local authority representation on charity boards.

7. A precarious stance on charity trading

- Government has wisely resisted the Cabinet Office's proposal to de-regulate the restrictions on trading imposed upon charities. The Joint Committee on the draft Charities Bill has re-opened the debate and recommended that the de-regulation of charity trading be re-addressed.

- There are very good reasons, however, for the existing regulatory regime; and de-regulation, while superficially attractive, should be resisted without careful thought. One possible compromise would be to relax the rules around the ability of charities to "invest" in their trading subsidiaries.

8. Failure fully to think through a number of "second level" issues and to address problems around the regulation of commercial participators

- The Bill has a considerable number of "second level" failings and drafting issues which should be addressed before it is enacted.

- There are problems with the regime around the regulation of commercial participators under the Charities Act 1992. The Bill does not address many of these.

POLICY PROPOSALS IN THIS PAPER

1. Ensure that the list of charitable purposes set out at S2 of the Bill is as succinct as possible and avoids over-definition.

2. Support the concordat between the Home Office and the Charity Commission on public benefit, and any Commission guidelines based upon it, provided that it can be rationalised with applicable case law, and provided that the least wealthy charities likely to be affected by the abolition of the public benefit presumption are not disproportionately disadvantaged.

3. Ensure that the application of the public benefit test is carried out reasonably, fairly and comprehensively.

4. Encourage and assist fee-charging charities to embrace the implementation of wider access and working in the wider community; and work with them to devise schemes that meet the public benefit test.

5. Investigate new ways in which the independent schools might be able to participate in providing services to the maintained school sector.

6. Ensure that the Bill makes clear on its face that the preservation of the existing law in relation to public benefit is the law as it develops from time to time and not only the law existing at the date the enacted Bill comes into force.

7. Ensure the Charity Commission is properly funded, staffed and trained to carry out its role before rather than after the Bill comes into effect.

8. Attempt to engender a greater sense of accountability to the charitable sector by requiring that the Commission convene a quarterly or bi-annual meeting between senior members of the Commission and senior members of the sector's key umbrella bodies such as NCVO, acevo and Volunteering England.

9. Ensure that a statutory duty is imposed on the Commission to ring-fence its regulatory functions from its advisory functions.

10. Ensure that the Commission is obliged, and not merely empowered, to give advice when it is formally sought.

11. Carry out a cost-benefit analysis to ensure that the Charitable Incorporated Organisation is really needed and that its implementation represents good value for money.

12. Ensure that appeals from the Charity Appeal Tribunal on issues of fact can be made to the High Court in appropriate circumstances.

13. Ensure that applicants to the Charity Appeal Tribunal can receive means-tested financial aid.

14. Ensure that the Commission can only recover its costs of an appeal to the Charity Appeal Tribunal from an appellant where the appellant has behaved frivolously or vexatiously (but not merely unreasonably).

15. Ensure that the Charity Appeal Tribunal is obliged to publicise its decisions and give reasons for them.

16. Empower the Attorney General to take points of general principle relating to charity law generally to the High Court of his or her own motion and without the need to intervene in charity proceedings.

17. Empower the Charity Appeal Tribunal to make orders protecting trustees from breach of trust where appropriate in respect of bringing an appeal to the Tribunal as a preliminary to their bringing that appeal.

18. Where the Commission has failed to make an order or decision in a way that amounts to delinquent delay without good reason, then if the order or decision – had it been made – would have been an appealable or reviewable matter under the enacted Bill, the affected party should be able to bring proceedings in the Charity Appeal Tribunal requesting the Tribunal to consider the matter and, if applicable, make the relevant order or decision.

19. Support the current position in the Bill that members of the Commission should be appointed for terms of up to three years provided that no member of the Commission may be appointed for more than ten years.

20. Support the current position in the Bill that the Commission, in performing its functions, must have regard (so far as is relevant) to the principles of best regulatory practice (including the principles under which regulatory authorities should be proportionate, accountable, consistent, transparent and targeted only at cases in which action is needed. Give further thought to how the relevance condition within this test should be determined, and whether that condition is necessary given the fact that regulation should only be targeted at cases in which action is needed. Give further thought to whether this obligation could include concepts of "reasonableness" and "fairness".

21. Support the current position in the Bill that the Commission must be independent from Government while at the same time maintaining its status as a non-ministerial Government department exercising its functions on behalf of the Crown.

22. The reserve power to regulate fundraising in the Bill should be subject to Parliament's affirmative procedure.

23. Ensure that, as part of a package of measures around the Bill, Government neutralises the adverse effect on charities of irrecoverable VAT (about £460 million each year).

24. Ensure that, as part of a package of measures around the Bill, Government re-enforces and assists its initiative to facilitate the ability of charities to engage with public bodies in the delivery of public services; for instance, by:

    - Ensuring that Government departments are not just aware of, but also apply, the Compact;

    - Ensuring that local authorities do not just have, but also apply, Local Compacts;

    - Clarifying the legal position about the extent to which charities can engage in public service delivery;

    - Clarifying the circumstances where public bodies can and should accept full cost recovery;

    - Encouraging a contract culture that envisages, for instance, fair allocation of risk and reward, advance payment structures, proportionate contractual terms and long-term contracts;

    - Facilitating a more accessible tendering process for charities without breaching applicable legal requirements;

- Considering the implementation of Compact Codes of Practice on Contracts and on Conflicts of Interest.

25. Allow paid executives of charities to comprise a minority on charity Boards, subject to certain specified safeguards.

26. Allow charities to trade indirectly by creating a new framework for the way in which charities can “invest” in their trading subsidiaries.

27. Adopt the secondary, but still important, suggestions about the Bill set out in Chapter 9.

28. Consider adopting the suggested changes to the regulatory regime set out in Chapter 9 in respect of “commercial participators” contained in Ss59-62 of the Charities Act 1992.

CHAPTER 1

INTRODUCTION

History of the Bill

The current Charities Bill was announced in the Queen's Speech on 17 May 2005; and the Bill was introduced into the House of Lords on 18 May 2005. References in this paper to the "Bill" are references to this Bill.

The Charities Bill was originally introduced into the House of Lords on 20 December 2004. References in this paper to the "original Bill" are to that Bill.

The original Bill derives from a draft Bill published on 27th May 2004 by the Home Office. This draft Bill was derived in turn from a review by the Cabinet Office in 2002 entitled "Private Action, Public Benefit"[1], which resulted in a consultation and Home Office report in 2003 entitled "Charities and Not-for-Profits: A Modern Legal Framework". The draft Bill, published in response to that report, was subjected to pre-legislative scrutiny by the Joint Parliamentary Scrutiny Committee on the draft Charities Bill, which published its report on 30 September 2004[2]. The original Bill received its second reading in the House of Lords on 20 January 2005 and underwent scrutiny in Grand Committee in the House of Lords between 3 February and 21 March 2005. A resulting

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1 Private Action, Public Benefit – A Review of Charities and the Wider Not-For-Profit Sector, Cabinet Office Strategy Unit Report 2002.

2 House of Lords/House of Commons Joint Committee on the Draft Charities Bill, HL Paper 167-1/HC660-1.

amended original Bill was issued on 23 March 2005. This paper, however, does not consider that amended original Bill.

The Bill's objectives

In its Reply to the Joint Committee[3], Government stated[4] that its aims for the Bill are to:

- provide a legal and regulatory environment that will enable all charities, however they work, to realise their potential as a force for good in society
- encourage a vibrant and diverse sector, independent of Government
- sustain high levels of public confidence in charities through effective regulation.

It further asserted[5] that "this is part of Government's wider strategy for the voluntary and community sector, which aims to encourage public support, to help the sector to become more effective and efficient, and to enable the sector to become a more active partner with Government in shaping policy and delivery… We believe that the Bill will vigorously promote all parts of this strategy… The Bill will build on this strong foundation of confidence in reforming charity law and regulation. It is part of Government's overall vision for the sector, in which strong, active and empowered communities will be increasingly capable of taking charge, and taking action".

In the foreword to the draft Bill, the then Home Secretary stated that:

> "One of the most important contributions Government can make to facilitating and promoting the activities of the sector is by creating a modern legal framework for it, which will enable the sector to operate in a dynamic and innovative fashion and which will preserve and build on the very considerable trust and esteem in which the public hold the sector."

This builds upon the Prime Minister's vision for the voluntary sector set out by him in his foreword to the Private Action, Public Benefit Review where he envisaged:

> "a package of measures which will modernise the law and enable a wide range of organisations to be more effective and innovative, whilst

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3 The Government Reply to the Report from the Joint Committee on the Draft Charities Bill Session 2003-04 HL Paper 167/HC 660.

4 At page 3.

5 At page 3.

maintaining the high levels of public trust and confidence which are vital to the continued success of the sector."

While much of the Bill is to be welcomed on a technical level, it fails to undertake some of the major reforms of the charitable sector that are necessary to prepare it for the future, and to fulfil Government's aspirations for it.

The purpose of this paper is to highlight some of the shortcomings of the Bill; and also to set out some of the issues that Government might have addressed had it been truly determined further to enable the sector better to carry out its charitable mission and, in the words of the Prime Minister, "to enable a wide range of organisations to be more effective and innovative".

The charitable sector in the UK

The charitable sector is an important contributor to our nation, both in economic terms, and in terms of social impact. There are about 189,000 registered charities in England and Wales, growing at a rate of about 1,800 each year.

In 2003[6] the UK's top 500 fundraising charities generated an overall income of £8.6 billion[7]. It is estimated that in 2003 the UK charity sector as a whole achieved an income of £32 billion. Of this, about 31% was derived from public donations and grants, 15% from legacies, 3% from the Lottery, 3% from fundraising events, about 15% from public bodies, about 21% from trading fees and contracts, and the rest from other sources[8].

In the same period the top 500 charities employed an average of 384 staff each[9]. In 2001[10], general charities[11] employed 451,000 full time equivalent jobs, or 2.3% of the workforce. It has been estimated that in 2002 some 569,000 people worked in the voluntary sector as a whole[12].The trend in 2001 was that employment in the charity sector was growing faster than in either the public or the private sector at 6.7%.

There can therefore be no doubt that charities comprise an important part of our economy, and of the fabric of our society.

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6 At the time of writing 2004 figures were not yet available.

7 The source for the information in this paragraph is Charity Trends 2004 published by the Charities Aid Foundation.

8 The proportions in which different sectors within the charity sector obtain its income from these sources varies considerably.

9 Source: Charity Trends 2004, published by the Charities Aid Foundation.

10 Unfortunately 2003 figures are hard to come by in this context. The source for the information about charities and employment in 2001 is the 2002 Cabinet Office Private Action, Public Benefit Review.

11 A definition used by the Office for National Statistics comprising 141,000 household name, National and local charities.

12 Report of the Joint Committee on the Draft Charities Bill, 30 September 2004, paragraph 2.

This has been reflected in a number of surveys between 1998 and 2002. For instance, 89% view charities as playing an essential role in society in satisfying unmet needs[13]. Over 70% say there were no other kinds of organisations they would trust above charities; and only 5% would not trust charities to spend donations wisely[14].

What is a charity?

"Charity" is a derivation of the Latin word "caritas", which means "care". What comprises charity in English law has expanded from this premise, and is based upon the preamble to the Charitable Uses Act 1601[15]. The preamble sets out a fairly disordered list of purposes from which the definition of charity is derived[16]. This list was classified by Lord MacNaughten in the case of Pemsel[17] which defined charitable purposes as purposes for:

- the relief of poverty
- the promotion of religion
- the promotion of education
- other purposes beneficial to the community.

To be charitable an organisation must, first, have objects that fall exclusively within one or more of these four heads; and secondly be for the public benefit. Any private benefit must, on balance, be secondary to the public benefit[18]. In the case of the first three heads of charity, public benefit is currently presumed, although the presumption is rebuttable.

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13 Source: "Blurred Vision: Public Trust in Charities", NCVO Research Quarterly Issue 1 (January 1998); cited in Joint Committee Report, DCH 15, Memorandum from the Home Office, at paragraph 2.

14 Source: "Disgusted or delighted: "what does concern the public about charities?", nfp Synergy (March 2004); cited in Joint Committee Report, DCH 15, Memorandum from the Home Office, at paragraph 5.

15 Usually known as the "Statute of Elizabeth".

16 The key preamble is as follows: "The relief of aged, impotent and poor people; the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars of universities; the repair of bridges, ports, havens, causeways, churches, sea banks and highways; the education and preferment of orphans; the relief, stock or maintenance of houses of correction; the marriages of poor maids; the supportation, aid and help of young tradesmen, handicraftsmen and persons decayed; the relief or redemption of prisoners or captives; and the aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers, and other taxes".

17 Income Tax Special Purposes Commissioners v Pemsel [1891] AC 531.

18 See, for instance, Tudor on Charities (9th Edition, 2002), who states at 1-008: "Where both benefit and harm flow from a particular purpose, the court will determine whether on balance there is public benefit. If the potential harm outweighs the benefits, the purpose will not be charitable. Thus a society having as its object the total suppression of vivisection was not charitable because any assumed public benefit in the advancement of morals was outweighed by the detriment to medical science and research and consequently to public health (National Anti-Vivisection Society v IRC [1948] AC 31)".

This broad definition has enabled charity law to develop with time and in response to evolving social circumstances; so that, for instance, urban and rural regeneration, community capacity building, human rights and environmental conservation may now be regarded as charitable. Equally, some purposes are no longer charitable: for instance gun clubs which, once considered charitable because they were beneficial to the community since they contributed to the defence of the Realm, were removed from the register of charities in the 1990s.

Most charities are regulated by the Charity Commission, which controls a list of registered charities[19]. The Commission determines whether an organisation is charitable upon an application for registration, and ensures that charities comply with the ongoing legal requirements, many of which are contained in the two current key pieces of legislation, the Charities Acts 1992 and 1993.

Government acknowledges that the charity sector is an important part of our economy and contributor to the cohesiveness of our society. As a result, it contemplates a new statutory regime that would modernise and re-invigorate the sector, empowering it for the challenges ahead. The Bill, while it is in many respects welcome as far as it goes, does not address the reforms needed fully to enable that modernisation and re-invigoration. This paper discusses some of the possible reasons why.

The Grand Committee on the original Charities Bill

The Grand Committee of the House of Lords on the Charities Bill met from 3 February 2005 until 21 March 2005. It is not the objective or place of this paper to summarise the Grand Committee debates in detail, but they are referred to at times within this paper when they are relevant to the subject-matter discussed.

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[19] There are also exempt and excepted charities. Exempt charities are currently listed in Schedule 2 of the Charities Act 1993 and include, for instance, the universities and halls of Oxford, Cambridge, London, Durham and Newcastle, grant-maintained schools, Higher Education Corporations, the National Lottery Charities Board, the Church Commissioners and any institution administered by them, and the trustees of a considerable number of museums, including the Victoria and Albert Museum, the National Gallery and the National Portrait Gallery. Under S3(5) of the Charities Act 1993 exempt charities are exempted from registration with the Commission. The Bill maintains this exemption at S9/3A(2)(a). The regulation of exempt charities by the Commission is however enhanced by S12 and Schedule 5 of the Bill, since currently certain powers of the Commission do not apply to them.

Excepted charities are currently excepted from registration pursuant to S3(5) of the 1993 Act. These include many church charities and other organisations excepted by order (see in particular the Charities (Exception from Registration) Regulations 1996 as amended by the Charities (Exception From Registration) (Amendment) Regulations 2002). There are a number of other orders excepting other charities including those relating to Boy Scouts and Girl Guides. S9/3A(2) of the Bill contemplates that excepted charities will not have to register with the Commission unless their gross income exceeds £100,000. This enhanced regulation may result in extra workload for the Commission that is discussed in Chapter 4 below.

The Joint Committee on the Draft Charities Bill

On 30 September 2004 the Parliamentary Joint Committee on the Draft Charities Bill, established in May 2004, published its report on the (then) draft Bill[20]. In all the Joint Committee made 54 recommendations. It is not the objective or place of this paper to summarise those recommendations fully, but the findings of the Joint Committee are referred to at times within this paper when they are relevant to the subject-matter discussed. Government published its Reply to the Joint Committee Report in December 2004[21], and this will also be referred to where relevant.

One criticism of the draft Bill by the Committee should be highlighted at this stage, however, in the context of Government's bold assertions about the positive impact it will have on the effectiveness of the sector. In its Overview[22], the Joint Committee states that:

> "Our primary concern is to ensure the draft Bill will deliver workable legislation that will enhance the role charities play in society. The majority of evidence we have received welcomes the draft Bill despite significant criticism of some of its provisions. However, we remain concerned that the Government's case for the draft Bill will be compromised unless there is greater clarity about the objectives against which its success can be gauged. In order to be meaningful the effect of legislation must – insofar as is practicable – be measurable; in order to be measurable it must have clear objectives".

This theme is again taken up later in the Overview[23]:

> "The imprecise rationale behind the draft Bill is again evident in the vague means by which the Government intends to assess its impact… We do not consider this approach to be satisfactory… We look for greater clarity about the practical means by which the Government will measure the impact of the Bill. We would have welcomed greater consistency about its key aims."

Confused objectives are not a sound basis upon which to base this proposed legislation. The Bill does attempt to address some of these concerns in S70, which requires the Secretary of State before the end of the period of five years after the Bill is passed as an Act, to appoint a person to review generally the operation of the Act. The Review must address, in particular, the effect of the Act on public confidence in charities, the level of charitable donations and the willingness of individuals to volunteer. It must also address the status of the Commission as a Government Department, and any other

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20 See above.

21 See above.

22 Joint Committee Report, paragraph 14.

23 Joint Committee Report, paragraphs 21 and 22.

matters the Secretary of State considers appropriate[24]. The resulting report must be laid before Parliament.

Despite this welcome adoption of one of the Recommendations of the Joint Committee on the Draft Bill[25], it remains unclear as to exactly how the impact of these issues to be reviewed might usefully be measured. It therefore appears that the Joint Committee's concern that it sought "greater clarity about the practical means by which the Government will measure the impact of the Bill" remains substantially to be addressed.

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[24] S70(2).

[25] Recommendation 51 of the Joint Committee Report recommended that the Bill should contain a requirement for the Secretary of State to review and report to Parliament on the impact of the Bill no later than five years after Royal Assent, and that the report should include an assessment of the effect of the legislation on public confidence in charities, the level of charitable donations and the willingness of individuals to volunteer. In its Reply, Government did not accept that this duty should be included in the Bill, but nevertheless undertook to report on the impact of the Bill on the matters recommended by the Joint Committee. It did not expand upon how that impact might be measured.

CHAPTER 2

CHARITABLE PURPOSES

As stated in the Introduction, for an organisation to be a charity under the law of England and Wales it must first be constituted for exclusively charitable purposes[26]; and secondly its objectives must be for the public benefit. The bodies responsible for determining whether a purpose is charitable and for the public benefit under the regime will, in the first instance, be the Commission[27]; and ultimately the High Court via the new Charity Appeal Tribunal[28].

This position is taken up by S1 of the Bill which states that for the purposes of the law of England and Wales "charity" means an institution which:

- is established for charitable purposes only and
- falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities.

S2(1) of the Bill states that for the purposes of the law of England and Wales, a charitable purpose is a purpose which falls within the list of charitable purposes in S2(2) and is for the public benefit as defined in S3.

This Chapter considers the definition of charitable purposes under S2 in the Bill; while Chapter 3 considers the necessary public benefit element of those purposes.

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[26] See, for instance, Tudor on Charities (9th edition, 2002), at 1-012.

[27] Pursuant to its custodianship of the Register of Charities under S3 of the Charities Act 1993.

[28] See Chapter 4 below.

Codifying the list of charitable purposes

The Charities Bill seeks to codify "softly" the charitable purposes derived from the Statute of Elizabeth and from Pemsel's Case.

The list at Section 2(2) seeks to set out in contemporary terms what are currently considered to be some of the major heads of charitable purpose as the law stands today. It is a non-exclusive list of some eleven specific purposes plus any other purposes recognised as charitable purposes under existing charity law or under the Recreational Charities Act 1958, any purposes reasonably analogous to or within the spirit of any of those purposes, and any purposes analogous to any of those analogous purposes. "Existing charity law" is defined by S2(6) as "charity law in force immediately before the day on which this section comes into force".

The implications of this are that what comprises a charitable purpose becomes preserved subject to the requirements of the Bill. The Courts are, however, entitled to exercise the so-called "double analogy" principle, which will continue to enable the law to evolve. This "double analogy" principle has been preserved in S2(4), so that the Courts can create new charitable purposes not only by analogy to current charitable purposes, but also by analogy to the analogy. This of course begs the question about what comprises an analogy; and it is clear that there are conflicting radical and conservative approaches to this, which the Bill does not seek to address. The question of the creative extent of the double analogy principle is therefore unclear[29].

It should additionally be pointed out that S2(5) of the Bill states that "where any of the terms used in any of paragraphs (a) to (k) of Subsection (2), or in Subsection (3), has a particular meaning under charity law[30], the term is to be taken as having the same meaning where it appears in that provision". This creates a further route to the development of the law of charitable purposes; for, to take one example, while S2 means that the purpose of "the advancement of citizenship" cannot alter, the Courts will be able to continue to develop what is understood by "citizenship" in the charitable context to the extent that "citizenship" has a particular meaning under charity law. Thus the law will be able to evolve under S2 not only by analogy, but also by development of the concepts behind the charitable heads in S2(2)(a) to (k). This approach is to be welcomed, although there are bound to be arguments about the extent to which a term used in paragraphs (a) to (k) of Subsection (2) has a particular meaning under charity law and, if, so, what that meaning might be.

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[29] This paper submits that S2(4)(b) could be more clearly drafted. It appears to be intended to apply the double analogy principle to S2(2)(a)-(k) as well as to S2(2)(l). The negative context in which subsections (a)-(k) are referred to in S2(4)(a) means that this is not absolutely clear, since it is not clear that those subsections "fall within" S2(4)(a) or that the reference in S2(4)(b) to "those paragraphs" refers to S2(2)(a)-(k). This should be clarified.

[30] S2(5) expressly refers here to "charity law" rather than "existing charity law", so that it is the law as it evolves from time to time.

A list of the charitable purposes set out at S2 of the Bill is set out at the end of Part A of the Annex to this Paper. An analysis of the way in which the law currently operates to determine if a purpose is charitable under existing law is set out at Part B to the Annex to this Paper.

The Grand Committee debated the list of charitable purposes at length, and there were a number of amendments moved for the expansion of the list. With respect, the list should be kept as short as possible for a number of reasons:

- it is non-exclusive[31]

- the longer the list, the more risk there is for it to be regarded as quasi-exclusive

- the more detailed the descriptions of charitable purposes in the list, the more risk there will be of confusion, ambiguity, disagreement and judicial intervention.

This paper is not the place to assess in detail the propriety or effectiveness of each of the charitable purposes in the list. One illustrative example of the dangers of attempting to "over-define" the list, however, lies in the charitable purpose at S2(2)(c) of the Bill – the advancement of religion. The issue here is that there have in the past been difficulties in polytheistic (such as Hinduism) and non-deistic (such as some forms of Buddhism) faiths achieving charitable status, although this is now often possible.

In Grand Committee debates there was concern to codify this position, and the Bill now includes a new S2(3)(a) which states that "religion" includes (i) a religion which involves belief in more than one god; and (ii) a religion which does not involve belief in a god. The Bill does not, however, strive to define what a "religion" might be. This provision was not included in the original Bill.

In its publication CC21 – Registering as a Charity[32], the Commission explains the way in which it currently assesses whether a faith or practice comprises a religion for the purposes of the third head in Pemsel[33]. For the purpose to comprise the advancement of religion, the religion has to be founded on a belief in a supreme being or beings and involve expression of that belief through worship[34].

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31 In the sense that the "other purposes beneficial to the community" purpose is preserved by S2(2)(l); and the double analogy principle is preserved by S2(4).

32 November 2004.

33 At paragraphs 19-21.

34 This definition is derived from a line of cases culminating in the judgement of Dillon J in Re South Place Ethical Society [1980] 1 WLR 1565. The Commission's thinking was formulated in its own Church of Scientology (England and Wales) decision made on 17th November 1999.

This could be argued to be an extremely wide definition – for instance it has been argued that it might cover satanism – until it is remembered that even if the purpose is a charitable purpose in principle, for it to be charitable in fact it must also be for the public benefit.

In the Grand Committee Lord Hodgson moved an amendment[35], the intent behind which was entirely admirable, to clarify what is meant by religion so that it "includes belief in a supernatural being, thing or principle, and acceptance and observance of canons of conduct in order to give effect to that belief". The fact that this is a non-exclusive definition makes it more flexible, but immediately one can see the difficulties with attempts to over-define:

- it is arguable whether it actually requires, or merely permits, acceptance and observance of canons of conduct as a pre-condition of qualification as a religion

- what is a canon of conduct and how substantial does it have to be?

- Does the canon of conduct actually have to be observed?

- Is a "thing" or a "principle" (not being a "being") capable of being supernatural?

- What do we mean by "supernatural" in this context?

- To what extent does this "belief" have to be established or observed before it can qualify?

The beauty of the current law is its flexibility and its ability to respond after due contemplation to contemporary circumstances[36]. If, for instance, some new following arises that is neither polytheistic nor non-deistic but which somehow becomes widely regarded a "religion", then the Courts, the Charity Appeal Tribunal or the Commission might be able to render the purpose a charitable purpose either by finding that it fell within the definition of a religion, or, if it was a "belief" which did not comprise a "religion" in itself[37], as a purpose beneficial to the community under S2(2)(l) and S2(4) of the Bill. To over-define what comprises "religion" for the purposes of the Bill might lead at best to uncertainty, and at worst to the abuse of the definition by organisations that

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35 See Hansard (Lords), 9 February 2005, from column GC57.

36 See, for instance, Commission Publication RR1a – Recognising New Charitable Purposes (2001), at paragraph 23, as endorsed by Tudor on Charities (9th Edition, 2003), at 1-006. The need to ensure that charitable purposes are compatible with the European Convention on Human Rights may mean that an increasingly flexible approach is needed over time. See further Part B of the Annex to this paper.

37 Humanism has been cited as an example.

could non properly be regarded as religions, so undermining public confidence in the sector.

The definition of what might comprise a "religion" should therefore not be partially defined in the Bill, and S2(3)(a) should be resisted. If S2(3)(a) is retained, it seems that the Commission will have to refine its definition to take account formally of the new statutory position that a "religion" includes a religion which does not involve belief in a god. How the Commission will achieve this is as yet unclear[38].

One argument in favour of broadening the definition is that not to do so might comprise a breach of the European Convention on Human Rights. An analysis of the arguments about this is set out in part B to the Annex to this paper; but this paper believes that any concerns here are largely unfounded.

A second illustrative example involves S2(2)(g) of the Bill which provides that the advancement of amateur sport is a charitable purpose. S2(3)(d) refines this so that "sport" means sport which involves physical skill and exertion.

This definition is intended to reflect the current position that many past-times such for instance as chess or bridge are not charitable purposes in themselves unless they are educational (so that for instance an adult chess club would be unlikely to comprise a charitable purpose while a school chess club might). The justification for energetic sport being a charitable purpose is that the promotion of physical fitness and health is beneficial to the community generally[39].

Consider for a moment, however, the new statutory definition of "sport": According to the Shorter Oxford Dictionary[40]:

- "sport" means "diversion, entertainment, fun; a past-time; an activity involving physical exertion [(sic)] and skill, especially one in which an individual competes against another or others to achieve the best performance"

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38 There is also a potential (although technical) tension between S2(3)(a) and S2(5) in that regard: what if the meaning of "religion" under S2(3)(a) and common law charity law in England and Wales from time to time are different at the time the Bill comes into force? Clearly the provisions of S2(3)(a) are intended to over-ride charity law to the extent the two conflict, but the Bill should say so, since otherwise arguably S2(5) maintains the current understanding of "religion" under charity law.

39 This paper does not address the issue about whether the advancement of chess and other analogous past times should comprise a charitable purpose. It is accepted that there has to be a high water mark on these issues otherwise what comprises a charity becomes increasingly meaningless. Another disadvantage of a codified list of charitable purposes is that it presents the opportunity for the executive to expand what comprises a charitable purpose beyond current case law, a remit previously reserved to the Courts. To its credit, Government has resisted this temptation to date.

40 Fifth edition, 2002.

- "exertion" means "the action or an act of exerting something, especially a faculty or power or of exerting oneself physically or mentally; an effort."

In Grand Committee, Lord Bassam, representing Government, stated[41] that "a common feature of the majority of activities in definitions of sport is that the activity requires a combination of, in varying degrees, physical skill and bodily exertion. You could add to that a mental facility as well[42]. Activities that involve physical skill and exertion could be expected to provide a health benefit to participants, and should therefore be recognised as charitable".

On this basis, does the movement of a chess piece require the "physical skill" of hand movement and hand-eye co-ordination – the sweep of a rook from one end of the board to the other, for instance? Does the movement of the piece require "exertion"? It could hardly be said there is no exertion at all in moving a chess piece: the simple fact of causing movement requires some exertion as any physicist will explain. In any event, does the mental facility resulting from chess not create a health benefit? One can see how the argument might be made.

The temptation to over-define the charitable purposes list must be resisted. As Lord Bassam stated in the Grand Committee[43], "the beauty of the way in which charity law has changed is that it has been able, through its flexibility, to respond to new and emerging circumstances".

The law should be left to weave its magic.

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41 Hansard (Lords), 9 February 2005, column GC90.

42 The drafting of S2(3)(d) does not make clear whether "sport" requires both physical skill and physical effort, or merely physical skill combined with other kinds of effort, for instance mental effort. This should be clarified. See in this context, however, S2(5) (above), which states that "where any of the terms used in any of paragraphs (a) to (k) of Subsection (2), or in Subsection (3), has a particular meaning under charity law, the term is to be taken as having the same meaning where it appears in that provision".

43 Hansard (Lords), 9 February 2005, column GC93.

CHAPTER 3

PUBLIC BENEFIT AND THE IMPLICATIONS OF THE REMOVAL OF ITS PRESUMPTION

The public benefit test under the Bill

For a purpose to be charitable it must not only be recognised as a charitable purpose by law, but it must also be for the public benefit. This is confirmed in S2(1) of the Bill as discussed in Chapter 2 above. S3(3) of the Bill states that any reference to the public benefit is a reference to the public benefit as that term is understood for the purposes of the law relating to charities in England and Wales[44]. The common law on public benefit is therefore preserved.

The law on public benefit is considerable and complex; and this paper is not the place to discuss it in detail. An analysis of the law on public benefit in the educational context, is, however, set out at Part C to the Annex to this paper.

The implications of the removal of the presumption of public benefit

Currently there is a legal presumption that charities for the advancement of poverty, education and religion are for the public benefit. As a result, they do not have to demonstrate public benefit either on registration or on an ongoing basis unless someone successfully shows on the balance of probability that their operations may not be for the public benefit.

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[44] It should be made absolutely clear on the face of the Bill that this is a reference to the law as it pertains from time to time, and not only at the time this Section of the Bill comes into force.

The Charities Bill seeks to abolish this presumption[45]. There are concerns that the abolition might have a considerable impact upon many charities that charge for the services they provide. These include hospitals, theatres and care homes whether for the elderly or the disabled; and, perhaps most controversially, independent schools. Although this discussion is relevant to a greater or lesser extent to all sectors of the charitable community, this Chapter focuses on the effect of the proposed abolition of the presumption on independent schools. As a result, a brief overview of the independent schools sector is appropriate.

The independent schools sector

The Independent Schools Council[46] (ISC) suggests that the independent schools' sector is flourishing. In its 2005 census, the ISC reported that ISC schools had maintained their market share, although overall pupil numbers in ISC schools had declined slightly, reflecting the demographic decline in the number of children of school age in the UK[47].

The total population in ISC schools in January 2004 was 504,141. The total population in all independent schools was some 620,000 pupils in 2,500 schools. There is a rising trend of the proportion of pupils educated in the independent schools sector year-on-year.

The overall average termly fee for an ISC school in 2004 was £3,259[48].

In 2004 independent schools spent £547.6 million. As well as this investment, independent schools have also invested in widening access to those who excel and/or who could not otherwise afford to pay their fees. The ISC reveals that[49] about 23.6% of all pupils in ISC schools received help with their fees from their schools (e.g. through scholarships, bursaries and other assistance), from a population of 504,141 (i.e. some 118,977 pupils). This was an increase of 2.2% from 2004 and suggests a healthy ongoing increasing trend[50]. The value of this help is not available from the 2005 census, but according to the ISC[51] in 2001 the annual sum disbursed by ISC schools in this way was £210 million, or 6% of turnover[52].

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45 Charities Bill, S3(2).

46 The ISC represents 1,276 independent schools within the UK where over 80% of independent school pupils are educated.

47 In 2004, the ISC reported a ninth year of continuous growth, with more pupils in ISC schools, more investment in facilities, and more help by independent schools with fees.

48 The discrete categories were: Boarding £6,276; day fee/boarding schools £3,305; day fee/day schools £2,556; day fee average £2,796.

49 Independent Schools Council Annual Census 2005.

50 The increase from 2002 to 2003 was 2.1%: ISC Annual Census 2004.

51 Source: ISC Publication "Good Neighbours – ISC Schools and their Local Communities", footnote to the Foreword, page 8.

52 Assuming a 4.5% increase year-on-year based upon the 2001 – 2002 increase in pupils supported, that sum today would be about £251 million.

83% of ISC schools are charitable (i.e. 1,061 independent schools in total). 93% of pupils in ISC schools (456,000) are in charitable ISC schools[53]. According to the ISC, the Department for Education and Skills consistently shows that about 19% of 16-19+ year olds are in fee paying schools[54]. Charitable ISC schools educate about just under 5% of the total population of pupils in the combined independent and maintained sector[55] between ages 4 to 19+.

Finally, it is not true that all independent schools are financially well off. For instance, apart from the few "household name" schools with substantial endowments, the majority of ISC schools have little in the way of endowments and are dependent for most of their income on fees. Over 50% of ISC schools have an annual turnover of £3 million or less and operate on a 2-3% margin – e.g. about £60,000-£90,000[56].

In many respects, the greatest sadness about the abolition of the presumption of public benefit for education is that it sends a message to the public that education is no longer valued as a public benefit in itself, and that the independent schools sector cannot be trusted to maximise its public benefit without enhanced scrutiny from the Commission. This is regrettable because, as will be explored further below, the independent schools can show a long and proud history of philanthropy in response to emerging social needs.

Tax reliefs for charitable independent schools

Charitable independent schools, along with other charities, benefit from a range of tax reliefs, such as:

- full income tax relief[57]
- full corporation tax relief[58]
- full capital gains tax relief[59]
- rates relief of between 80% and 100%[60]

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53 Joint Committee Report, DCH 9, Memorandum from the Independent Schools Council.

54 David Miliband, Minister of State for Schools Standards, House of Commons Written Answer, 22 June 2004; quoted in Joint Committee Report, DCH 278, Supplementary Memorandum from the Independent Schools Council.

55 According to the Department for Education and Skills' figures in January 2003 there were the following numbers in the maintained sector: primary 5,178,200; secondary 3,995,000; special 105,600.

56 See Joint Committee Report, Ev 171.

57 If a trust, see S505(1), Taxes Act 1988.

58 If a company, S832(1), Taxes Act 1988.

59 S256(1), Taxation of Chargeable Gains Act 1992.

- relief from stamp duty in certain circumstances[61]

- relief from taxation on certain otherwise taxable trades, for instance primary purpose and ancillary trading, and small and mixed trading within certain limits[62]

- the ability to reclaim basic rate tax (currently about 28%) in respect of donations made by individuals to the charity by Gift Aid from the Inland Revenue to the extent that it has been paid by the donor[63].

The position regarding VAT is more difficult. Superficially, the independent schools are in a beneficial VAT position because the provision of education by a recognised school or a charity will be an exempt supply[64]. Accordingly VAT will not be chargeable on school fees, making them more affordable to parents seeking to send their children to independent schools.

This exemption can be a cause of great difficulty, however, because its result will also be that in many cases schools will be unable to register for VAT, and therefore will be unable to reclaim VAT paid by them to their own VAT registered suppliers. The issue of irrecoverable VAT is dealt with in more detail in Chapter 6. Suffice to say here, however, that the ISC has estimated[65] that the irrecoverable VAT burden for independent schools is about £170 million each year; and that this burden is about twice the annual tax benefits from charitable status.

Charitable independent schools and the public benefit

Some people argue that independent schools should not enjoy charitable status because they do not deliver a sufficient public benefit. They assert that, because independent school fees are prohibitive to many of the less fortunate in our society, they confer a private benefit on those who can afford the fees, and so do not meet the necessary threshold of public benefit. This is known as the "wider access" argument, and is an important point of view. It deserves to be treated with respect, and with sensitivity towards the social concerns of those who hold it. Nevertheless, there can be little doubt that the independent schools have provided substantial public benefit in a number of ways, and not just to those who can afford to walk through their gates.

The wider access debate arises from the fact that, by their very nature, charities must benefit the public, so any private benefit must be incidental in

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60 Local Government Finance Act 1988.

61 S129 Finance Act 1982.

62 See, for instance, Inland Revenue online Guidance for Charities, Annex IV (Trading).

63 S25(1) and (2) Finance Act 1990, as amended by S39 Finance Act 2000.

64 VAT Act 1994, Schedule 9, Group 6.

65 Joint Committee Report, DCH 9, Memorandum from the Independent Schools Council.

nature. This is so whether or not there is a presumption. For instance, in its publication RR8 "The Public Character of Charity"[66], the Commission sets out its current position on public benefit and states that:

> "The public character of charity is upheld by ensuring that an organisation benefits either the public as a whole, or a sufficient section of it. Whether this is the case can only be decided on a case-by-case basis."

The Courts have interpreted what is meat by a "sufficient section" of the community as follows:

> "These words "section of the community" have no special sanctity, but they conveniently indicate first, that the possible (I emphasise the word "possible") beneficiaries must not be numerically negligible, and secondly, that the quality which distinguishes them from other members of the community, so that they form by themselves a section of it, must be a quality which does not depend on their relationship to a particular individual"[67].

Later, when assessing to what extent individuals may benefit privately, the Commission states in RR8 that:

> "…a private benefit is legitimately incidental if it arises as a necessary but incidental consequence of a decision by the trustees which is directed only at furthering the organisation's charitable purposes (as opposed to a separate purpose of in effect providing private benefit), and the amount of benefit is reasonable."

When charging arises, the question of social exclusion may also arise: if the charges are sufficiently high so as to exclude the poorest in our society, can the organisation be said to be charitable when it has, by virtue of its charging structure, created barriers to the poorest benefiting from the charity's operations?

This is not a simple question. In this context, however, it is important to bear in mind a number of points:

- educational charities such as the independent schools are founded to advance education, not the relief of the poor

- it is well established that charities do not have to benefit potentially the *whole* community, merely *a sufficient section* of it. Numerous charities exist to service only a very small class of beneficiaries, for instance

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66 The Commission has indicated that it will revise RR8 in the light of the ultimate wording of the Bill once it is enacted, and of the Home Office/Commission concordat on the definition of public benefit (see below).

67 Oppenheim v Tobacco Securities Trust Co Ltd [1951] AC 297, per Lord Simonds.

charities maintaining village halls in particular localities with only a few thousand inhabitants

- the presumption of public benefit is exactly that – a presumption! Its abolition does not change the legal test, but merely shifts the evidential bias so that it is for the independent schools to demonstrate on the balance of probabilities that they operate for the public benefit, rather than for an interested third party to challenge the fulfilment of the public benefit. It has always been open to interested third parties to seek to *rebut* the presumption by demonstrating, on the balance of probabilities, that a charging charity was, as a result of its charges, not operating for the public benefit[68]. Such third parties might include, for instance, the Attorney General in his or her capacity as parens patriae to protect the interests of beneficiaries

- charities should be able to charge a reasonable fee for the services they provide, as long as the fee is applied to furthering the charity's objects and not to any non-incidental private benefit (e.g. paying teachers is fine)

- when deciding whether to set, or when setting the tariff for, fees, trustees must always act in the best interests of their charity. Accordingly, they must determine if the fact and amount of fees is the best way for them to fulfil their charitable objects and benefit their beneficiaries. It is not always inevitable that setting high fees will be the best way to do this. In the case of most independent schools however, they will not have endowments or other grants or funding sufficient to enable the trustees to avoid charging fees. As a result, the only way for them to be able to fulfil their charitable objectives will be to charge the fees necessary to cover the operating costs of the school together with a prudent reserve and an appropriate surplus to enable ongoing investment including development of buildings and other facilities, etc.

In RR8, the Charity Commission sets out its current guidelines about what principles trustees of charging charities should apply when setting charges[69]:

- charges should be reasonable

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[68] For instance, Tudor on Charities (9th Ed, 2003) says (at 1-008): "Established English law provides that where the purpose appears to be for the relief of poverty or the advancement of education or the advancement of religion the court will assume it to be for the benefit of the community and, therefore, charitable unless the contrary is shown. In such a case it is for those who dispute the validity of the gift or trust to satisfy the court that the community will not be benefited. So, for example, a trust for the advancement of education will not be charitable if it is shown that the particular education is not of public value, (National Anti-Vivisection Society v IRC [1948] AC 31 at 49)".

[69] These guidelines will almost certainly be superseded by any new guidelines published by the Commission in the light of the enacted Charities Bill and the concordat reached between the Commission and the Home Office. See below.

- charges may, if appropriate to the overall purposes of the charity, be set at a rate that generates a surplus to help fund the charity's other current or future activities. Looking at the overall purposes of the charity includes taking general account of the circumstances of its indented beneficiaries

- no charge should be set at a level which deters or excludes a substantial proportion of the beneficiary class since this would be contrary to the purpose of the charity

- the service provided should not cater only for those who are financially well-off. It should in principle be open to all potential beneficiaries (as opposed to entire exclusion of those with limited financial means)

- It should be clear that there is a sufficient general benefit to the community directly or indirectly from the existence of the service.

A number of matters arise from this. First, is the fact that the Commission to date considers that direct and indirect benefit to the community is relevant[70]. This means that, in relation to the independent schools for instance, not only the direct benefit to pupils at independent schools can be taken into account, but also the indirect benefit of their education to society as a whole.

It is also arguable that the indirect benefit to the state school system could be taken into account, since the fact of the charitable independent schools, by taking some 456,000 pupils out of the state school system year-on-year, means that the state school sector has more money to spend on those who either cannot afford or do not choose an independent school education (relief of the public sector). The Chancellor of the Exchequer has admitted as much when he said[71] that independent schools save the exchequer £1.98 billion each year, enabling that sum to be spent within the maintained school sector.

In the light of this, and apart from the obvious public good of education in itself, according to the ISC the independent schools provide a series of public benefits, which include:

- on Government's own figures, the education of 440,000 pupils from the UK in independent schools saves the exchequer £1.98 billion each year[72]

- this £1.98 billion saving is some 22.5 times the value of the fiscal benefits to independent schools of charitable status

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70 See, for instance, Le Cras v Perpetual Trustee Co Ltd [1967] 3 All ER 915 ("Re Resch"), discussed further in the Annex to this Paper.

71 Budget Speech, 17 March 2004.

72 Speech by the Chancellor of the Exchequer, 17 March 2004, as above.

- the VAT exemption on fees in relation to the supply of education by independent schools that are charities undermines the fiscal benefits to independent schools of charitable status

- many ISC schools actively raise funds to increase their ability to educate pupils from less well off families

- ISC schools give £2:30 in assistance for every £1:00 gained through charitable status. Of this assistance, 50% is allocated through means testing

- 12% of pupils in ISC schools have special educational needs, including dyslexia and dyspraxia[73].

Wider access schemes

The ISC has concluded from a survey that there had been a significant growth in the provision of wider access and community support and engagement since 1992. In 2003:

- nine out of ten (88.7%) responding schools made at least one facility available for outside use

- maintained schools were not charged by well over half (58.9%) the schools that allowed them to make their facilities, and community groups by well over a quarter (27.6%)

- with regard to partnership activities, the beneficiaries of partnership activities are principally the disadvantaged, maintained schools, the local community and good causes home and abroad

- over half (53.4%) the responding schools were involved in at least one partnership activity not funded by Government

- of those schools that described one activity, 20.5% described a second and 10.6% described a third

- large schools found it easier to undertake partnership activities than small schools and therefore a higher percentage of them do so (68.4% as against 38.9%)

- 70.5% of the costs of partnering activities are borne by the independent schools.

This illustrates that the independent schools sector seeks to widen access through responsible programmes of scholarships, bursaries and assistance. It

[73] ISC Census 2004. No figures appear to be available in the ISC Census 2005.

also seeks to build partnerships with the maintained school sector and with the wider community. These partnership activities in ISC schools include making teaching and learning activities available on the internet; the provision of teaching in specialist or minority subjects where provision is lacking in the maintained sector; special tuition for children from maintained schools who are seeking places at leading universities; and specialist tuition in music, drama and the arts. Many schools are active in the independent/state school partnership scheme and are giving up time and experience to help establish City Academies[74].

Taking one prominent example, in its written evidence to the Joint Committee[75], Eton College stated that 19.4% of its pupils hold scholarships or bursaries. Scholarships may be, and bursaries are, means tested. Bursaries are means-tested assistance with fees that may be added to scholarships or given to pupils who might not otherwise be able to afford to attend Eton. The overall cost of scholarships and bursaries is about £2.8 million each year. Eton College further benefits the community through an impressive range of other "wider access" and community projects.

The ISC in its evidence to the Joint Committee[76] held out the independent schools in Manchester as a prime example of innovative delivery of public benefit and wider access. Similar submissions outlining wider access were made by a number of other schools, including Christ's Hospital[77] and Rugby School[78]. It is hard to see how such activities – on top of the basic educational public benefit already provided - could not render these independent schools publicly beneficial on the measure of any reasonable person.

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[74] Joint Committee Report, DCH 9, Memorandum from the Independent Schools Council. The City Academies programme intends to raise educational attainment by establishing a new kind of secondary school in disadvantaged urban areas. These will be publicly funded independent schools, with sponsors from the voluntary sector, business or faith groups. In October 2002 David Miliband made an appeal to headmasters of the independent school sector to lend their support to the new Academies. Their objective is to raise educational attainment by establishing a new kind of secondary school in disadvantaged urban areas. They will be publicly funded independent schools with sponsors from the voluntary sector, business or faith groups. City Academies may replace one or more under-performing existing schools, or they may be new schools where there is an unmet need for places. (See, in particular, www.dfes.gov.uk).

David Miliband has stated that the new Academies would be "pioneers, independent schools in the state sector, moving beyond the traditional principle of comprehensive intake to offer genuinely comprehensive provision… They are about human links that will motivate pupils and energise teaching". (Source: The Guardian, October 9 2002, article by Rebecca Smithers). There are currently about seventeen Acadamies, with Government wishing to introduce up to 200 more by 2010 with about £2 million in private sponsorship for each one. The project is controversial: see, for instance FT.com, March 29 2005, "Teachers step up attack on inner-city academies" by Miranda Green; and article by John Clare and Liz Lightfoot in the Daily Telegraph on 29 March 2005, "Creationists and capitalists are taking over city academies".

[75] Joint Committee Report, DCH 46, Memorandum from Eton College.

[76] Joint Committee Report, DCH 9, Memorandum from the Independent Schools Council.

[77] Joint Committee Report, DCH 232, Memorandum from Christ's Hospital.

[78] Joint Committee Report, DCH 238, Memorandum from Rugby School.

There is also a strong argument that charitable status in itself widens access. The ISC, in its evidence to the Joint Committee[79], states that charitable status:

> "enables schools to increase the availability of means tested bursaries for children from less well off families. More particularly, charitable status encourages schools to launch appeals to fund means-tested bursaries and encourages potential donors to give to those appeals. If charitable status were removed, there would be fewer donations, fewer bursaries, and reduced access to children from less well-off families".

Equally, to its credit, the ISC regards wider access as a natural remit for the charitable independent schools. In its evidence to the Joint Committee it said[80]:

> "The main effect of charitable status is to widen access. It also provides us with some money to widen access. It also provides us with a social purpose to widen access to people who cannot afford the fees and it is the final and conclusive answer to those parents who say "Why should my fees be used to subsidise other children who cannot pay". The answer is because it is our job. That is the key thing".

Other public benefits provided by charitable independent schools include the fact that they earn over £283 million each year to the benefit of the national economy from fees paid in respect of overseas pupils[81]; the fact that the charitable status of independent schools stimulates increased donations to education; and the stimulation of excellence and innovative educational techniques.

The ISC has argued that this facilitation of public benefit is historic. For instance, it states in its 2003 "Good Neighbours" Report[82] that:

> "It should not be supposed that the independent schools embarked upon charitable enterprises only when their charitable status began to be called in question. On the contrary, service (before that word became unfashionable) has always been part of their ethos and, long before the welfare state was a gleam in a politician's eye, philanthropic, charitable and relief work in inner cities and other deprived areas was undertaken both institutionally by the public schools (often in the setting up of boys' clubs) and individually by their alumni who had imbibed from their education a spirit of service for those less favoured than themselves. Those who have taught in the independent sector have always understood that there is little justification for their work if pupils

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79 Joint Committee Report, DCH 9, Memorandum from the Independent Schools Council, at Paragraph 28.

80 Joint Committee Report, Ev 163, (Mr Shepard).

81 Joint Committee Report, Ev 165, (Mr Shepard).

82 As above, page 5.

> grow up to use the benefits of their education only for their own advancement and profit. The nature, the scope and the method of independent school charitable activity may have changed over the years, but the principle has remained constant".

Other arguments often levelled against the independent schools are that they are elitist and perpetuate a "them and us" society; that they exist to make a profit; that wider access is based upon aptitude rather than means; and that disabled access is not necessarily higher than that in the maintained schools.

These arguments can be countered: the ISC census and its evidence to the Joint Committee establishes that those who send their children to independent schools do not typically belong to what one might call a "privileged" section of society, and often make considerable sacrifices to do so[83]. Equally, it is not true to say that most independent schools are well-endowed. It is true that the independent schools exist to make a profit, but so does any charity that wants to grow year-on-year. The key is that the charitable independent schools in their constitutions will have a lock on asset distribution so that the profit must be applied to each school's charitable purposes[84]. With regard to aptitude, the ISC evidence suggests that it is important to distinguish between scholarships, which are based on aptitude, and bursaries, which are not. According to the ISC, of the £219 million disbursed by ISC schools in 2000-2001, 49% was disbursed through bursaries, and 47% to scholarships[85]. While it may be true that disabled access is no higher than for maintained schools, the disabled access figure for independent schools is about 12%[86]. While no doubt this figure could be improved upon, it demonstrates a clear commitment to extend, and significant success in extending, access to those with special needs.

Wider access and the law

This whole debate has been confused by the fact that the Commission, in its initial evidence to the Joint Committee[87] and despite the general guidance given in RR8, stated that because of applicable case law wider access would not be a relevant factor in assessing public benefit for the independent schools. This stance dismayed the Home Office, which held a conflicting view.

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83 See for example, Joint Committee Report, Ev 166-167.

84 This is a common misunderstanding fuelled by the unfortunate common use of the phrase "not-for-profit" when describing a charity. "Non-profit-distributing" would be a better and more accurate description.

85 Joint Committee Report, DCH 278, Supplementary Memorandum from the Independent Schools Council.

86 Joint Committee Report, Ev 165, (Mr Shepard).

87 Joint Committee Report, Ev 192.

A legal wrangle then resulted which has not yet been properly resolved, and which can only undermine the plans and operations of many fee-charging charities including the independent schools which need certainty about what is to be expected of them in future.

An analysis of the two arguments about wider access in relation to educational charities is set out at Part C to the Annex to this paper. First, however, it is important to recognise that the Bill as currently drafted does not seek to define what comprises public benefit, but instead cross-refers to the public benefit as that term is understood for the purposes of the law relating to charities in England and Wales[88]. Accordingly, unless the position is changed before the Bill becomes law, the Courts will still ultimately reign supreme in defining public benefit; and existing case law will still bind the Commission in the way in which it approaches the public benefit question[89].

This uncertainty alarmed the Joint Committee, which had hoped that the abolition of the presumption might have had a substantial impact on charities that charged. In its Report, the Joint Committee stated that:

> "[The Commission's] interpretation left the draft Bill in the ludicrous position of promising to bite on the public benefit bullet without having any teeth to do so. …This position was based on an interpretation of the law which was supported by some of our witnesses and disputed by others. Most significantly and perplexingly it became clear that the Home Office and the Charity Commission saw things differently. This is deeply unsatisfactory. For a matter of such public importance and interest to produce such total confusion at the heart of the draft Bill is nothing short of farcical"[90].

As a result of the Joint Committee's criticism, the Home Office and the Commission have devised a joint concordat in an attempt to resolve their differences about the current legal position. An analysis of the concordat and its possible effects is set out at Part C of the Annex to this paper.

In brief, however, the concordat asserts that what comprises public benefit is capable of evolving and developing over time with regard to both particular charitable purposes and the social and economic changes in society. It also attempts to strike a balance on the wider access argument: first, while the fact that charitable facilities will be charged for and may be provided mainly to people who can afford to pay does not necessarily mean that the organisation

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88 Charities Bill S3(3).

89 As discussed in Chapter 3 below, the emergence of the new Charity Appeal Tribunal (CAT) will mean that public benefit questions, whether of fact or law, arising from a decision of the Commission will first be heard by the CAT. Nevertheless, any incorrect legal test applied will be capable of appeal to the High Court, so that the CAT will not undermine the supremacy of the Courts in this context. Findings of fact by the CAT cannot be appealed to the High Court however as the Bill is currently drafted – a considerable failing which is explored further in Chapter 4.

90 Joint Committee Report, paragraph 76.

does not operate for the public benefit; nevertheless secondly, an organisation which wholly excluded poor people from any benefits, direct or indirect, would not be established or operate for the public benefit and therefore would not be a charity.

It is possible, however, that the concordat does not accurately reflect applicable law in the context of the application of the public benefit test to educational charities that charge.

This has been acknowledged by Government in its reply to the Joint Committee Report[91] when it states that "we do not see the principles in the letter as forming a complete basis for an explanation of public benefit, although they do form a good partial basis"[92].

From that "good partial basis", Government envisages that the Commission will publish revised guidance, for instance by the revision of RR8:

> "We…. [p]refer the option of having the public benefit principles stated in guidance which explains the law, and aims to generate greater general awareness of what public benefit means in the context of charity, but is not itself part of the law. The advantages of this are that it provides maximum flexibility for the law to develop in response to changes in society and that it allows for all, rather than just some, of the public benefit principles to be set out and explained"[93].

To enable this, S4 of the Bill contains a requirement that the Commission must issue guidance in pursuance of its public benefit objective to promote awareness and understanding of the public benefit requirement for all charities[94]. The Commission must carry out such public and other consultation as it considers appropriate before issuing or revising any guidance[95]. It must publish the guidance in such manner as it considers appropriate[96]; and the trustees of a charity must have regard to the guidance when exercising any powers or duties in respect of which the guidance is relevant[97].

While this obligation to issue guidance about public benefit is welcome, it remains likely that any such guidance will be based on the concordat. In any event, the ultimate test of public benefit with regard to each class of charity

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91 See above, at page 5, paragraph 3.

92 From the language of the concordat, it does not appear that the Home Office regarded the concordat as merely a "good partial basis" in the context of fee-charging charities when it was submitted to the Joint Committee.

93 Government Reply to the Joint Committee Report, paragraph 8, at page 7.

94 Ss4(1) and 4(2).

95 S4(4).

96 S4(5).

97 S4(6).

will rest with the Courts – the Charity Commission's guidance will not be the final say on the matter[98].

In the light of the obligation to publish guidance, the Commission published two important papers in January 2005: first "Public Benefit – the legal principles"; and secondly, "Public Benefit – the Charity Commission's approach".

In "Public Benefit – the legal principles", the Commission states[99] that in considering the extent to which charging by a charity might affect its ability to demonstrate benefit to the public, the following broad principles apply:

- both direct and indirect benefits to the public, or a sufficient section of the public, may be taken into account in deciding whether an organisation is set up and operates for the benefit of the public

- the fact that the charitable facilities or services will be charged for, and will be provided mainly to people who can afford to pay the charges, does not necessarily mean that the organisation is not set up for, and does not operate for the benefit of the public

- an organisation which wholly excluded less well off people from any benefits, direct or indirect, would not be set up and operate for the benefit of the public and therefore would not be a charity.

In applying this approach to cases where high fees are charged for services or facilities provided, the Commission will consider the following[100]:

- does the level at which fees are set have the effect of preventing or deterring the less well-off from accessing the services or facilities?

- If so, can it be shown that the less well off are not wholly excluded from any possible benefits, direct or indirect?

This analysis is considered in more detail in Part C of the Annex to this paper.

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98 In its Reply to the Joint Committee Report (paragraph 8, page 7) Government notes the concerns about guidance being issued by Government based on the principle that there should be no Government control over any aspect of the definition of charity. The Reply states that "To remove that risk we therefore intend in the Bill to place the guidance-making function not with the Secretary of State but with the Charity Commission as the independent regulator which is not under Government direction or control". While the provisions of S4 of the Bill are to be welcomed, the circumstances of the concordat suggest that the Commission's position on the public benefit test with regard to fee-charging charities continues to evolve in concert with the Home Office. Re-assurance on this concern might be gleaned, however, from S6(4) of the Bill which entrenches the independence of the Commission form the direction or control of any Minister of the Crown or other Government department.

99 At paragraph 34.

100 "Public Benefit – the legal principles", at paragraph 35.

In “Public Benefit – the Charity Commission’s approach” the Commission sets out the way in which it will apply the public benefit test. In relation to existing charities[101] the Commission concedes that it is still considering the best way of carrying out these checks, but this might include a public benefit section in the annual return that registered charities must submit to the Commission.

The Commission also states[102] that it will develop greater awareness and understanding of the public benefit requirement through the implementation of a four stage process. This is discussed more fully in Part C of the Annex to this paper.

The possible effect of the concordat and resulting Charity Commission guidance on charitable independent schools

The concordat and the preliminary guidance of the Commission published in January 2005 may worst affect the poorest independent schools, since they might not be able to afford to devise access widening schemes that satisfy the Commission. It is said, for instance, that the “average” independent school operates a 2-3% margin on a turnover of about £3 million[103], which is only about £90,000. For some, therefore, a broad access widening initiative might simply be out of reach. Ironically, therefore, it will be the least “privileged” independent schools that appear to be prejudiced most by the concordat and the Commission’s latest guidelines. This is clearly unfair, and must be addressed as a matter of urgency.

Independent schools and the new public benefit challenge

The argument about the charitable status of independent schools is not a question about whether independent schools should exist; but rather about whether they should receive the public subsidy of the range of tax reliefs available to charities[104]. In that light, and despite the concerns about the concordat expressed above, it is appropriate that independent schools should have to demonstrate public benefit.

The independent schools generally appear to welcome this challenge, and it is to their credit that they take a highly responsible attitude in this regard. For instance, rather than hiding behind the Schools Cases, the ISC chooses to take its stand on a broader provision of public benefit by the schools it represents. For instance, in its evidence to the Joint Committee, the ISC stated that:

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101 See paragraph 30.

102 See paragraphs 31 – 41.

103 See Joint Committee Report, Ev 171.

104 See above.

> "We want schools to provide public benefit. We are very confident that the vast majority of ISC schools do, and to a great extent. If there are schools that do not then they should pull their socks up".

When asked if the abolition of the presumption of public benefit should be used as "a lever to make schools change the way they operate and provide more public benefit", it was said:

> "Yes, it is self-evident; that is the world in which we live. We are accountable".

What is not right, however, is that the independent schools should have to endure uncertainty about the future evolution of what comprises public benefit generally, and the extent to which they have to provide for wider access to those who might not otherwise be able to afford access. The independent schools need a clear benchmark against which to develop the public benefit they provide.

The evidence given to the Joint Committee demonstrated that the removal of charitable status from independent schools would be likely to make some schools unviable. For instance, one headmaster stated that:

> "The loss of charitable status would increase the costs… by £335,000 a year. That is unequivocally £335,000 which that school would not be able to spend on the community, on bursary places, on widening access and on giving places on purely merit grounds[105]…"

> "There is a financial benefit from charitable status. As a fundraiser, there is a tremendous benefit to the charity which I run in enabling it to raise money to fulfil its charitable purposes. It is a huge asset"[106].

It is not clear what will happen to the assets of independent schools if their charitable status is removed. This is discussed in more detail in Part C of the Annex to this paper; but arguably, their assets will be applied by a scheme of the Court or the Commission to fulfil objects in the educational field that are charitable. This might mean a re-structuring of the school's fee and access structure, or the removal of the school's assets from its trustees. Alternatively, it might mean that the school would be deprived on an ongoing basis of the tax reliefs that it had previously enjoyed, which might make numerous independent schools unviable as a going concern[107].

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[105] Joint Committee Report, paragraph 87; from Q478 (Dr Stephen).

[106] Joint Committee Report, paragraph 87; from Q457 (Dr Stephen).

[107] There are obvious Wednesbury reasonableness and proportionality issues here concerning the removal of charitable status from organisations that were admitted to the register on the basis of one test and are later removed from the register on the basis of another. This will be discussed further below.

Oddly, in relation to the many independent schools, a loss of charitable status may result in yet higher fees that make them even further out of reach for those who cannot afford their fees. This was a point taken up by Eton College in its written evidence to the Commission, when it said[108]:

> "Loss of charitable status by abolition or by raising the Public Benefit bar unreasonably high would reduce access to the school by cutting the number of scholarships and bursaries and severely limit the assistance given to others as outlined [in the Memorandum][109]".

One immediate effect the abolition of the presumption will have is that independent schools will have to assess the risk of their being unable to fulfil the public benefit test as part of their required risk assessment under the Charity SORP 2000. Auditors are said to be already requiring this, and expecting trustees to make a statement about public benefit in their annual reports.

In addition, there is always the concern of further more radical "solutions" to the question of the independent schools. For instance, in its Report the Joint Committee made a suggestion (which it accepted was "radical" and which it did not formalise as a recommendation) that:

> "…we believe that the Government should consider reviewing the charitable status of independent schools and hospitals with a view to considering whether the best long-term solution might lie in those organisations ceasing to be charities but receiving favourable tax treatment in exchange for clear demonstration of quantified public benefits"[110].

With respect, this attempt to mollify that sector of the community that would do away with the independent schools does not make sense. First, what the independent schools need now and in the light of the Bill is certainty, not the threat of some further re-structuring on the horizon. Secondly, frankly, if an independent school can demonstrate public benefit, then it deserves to be a charity. Thirdly, it is not clear what advantage there is to removing charitable status from independent schools if tax reliefs are going to be maintained within whatever substitutionary structure is adopted[111].

This is all very strange in the context of a Bill that seeks to entrench Higher Education Corporations and Further Education Corporations as charities[112] at a time when the prospect of "top-up fees" will render access to universities

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[108] Joint Committee Report, DCH 46, Memorandum from Eton College, paragraph 7.1.

[109] See above for a brief description of this assistance.

[110] Joint Committee Report, paragraph 95.

[111] In its Reply to the Joint Committee Report, Government rejected this informal proposal by the Joint Committee (paragraph 8, page 7).

[112] See, for instance, Bill, Schedule 7, Sections 82 and 86.

considerably more difficult to significant sections of the community. What are the independent schools to make of this mixed message?

One way forward to a greater public good

To their credit the independent schools have chosen not to take advantage of this legal confusion, but to take a highly responsible approach so as to rise to the challenge of the enhanced public benefit requirements that may be expected of them under the concordat. Indeed, it appears that many schools may choose to exceed these expectations in the discharge of the age-old mission of public benefit that the independent schools have traditionally espoused.

They will seek to continue to embrace in ever more innovative ways a general service within the broader community, which will include the highly desirable goal of wider access to the extent possible within the constraints of reasonable fiscal efficacy for each school.

The independent schools can do this in the responsible knowledge that the concordat provides a welcome opportunity for the independent schools to engage consensually with the Commission to agree a mutually beneficial protocol provided it takes into account the reasonable fiscal efficacy of each school in relation to wider access on a case-by-case basis. The independent schools must re-assert responsible guardianship of the public gifts they receive, and in so doing promote innovation within the charitable mission of education they have embraced to the greater good of our society.

As part of this way forward the independent schools might consider whether, as part of their wider public benefit brief, they should establish systems that enable them to widen access to educational excellence and innovation by delivering public services over time – for instance by providing educational services to the maintained school sector. As will be seen in Chapter 7 below, there is a considerable debate about what might comprise the “added value” of charities delivering public services; but if it is true, as appears to be the case, that the charitable independent schools can more easily achieve educational excellence, and be more innovative and exploratory, than the maintained sector schools, then there may be a clear “added value” which could be applied more broadly to the maintained school sector through public service delivery.

Of course, any such programme would have to preserve the integrity of the independent schools’ core brief. But if the independent schools are serious about wishing to deliver best practice in practical maximisation of public benefit, then they should consider this suggestion seriously, and with an eye to the long-term view.

Should there be a statutory public benefit test?

A statutory public benefit test should be resisted, and public benefit should continue ultimately to be determined by the Courts. The main reasons for this are the interpretative difficulties the application of a statutory public benefit test would attract; and the fact that what comprises public benefit is more properly ultimately determined by the Courts and not by the executive, to avoid influences of political expediency. A more detailed analysis of this issue is set out in Part C of the Annex to this paper. But this approach has been accepted by Government in its Reply to the Joint Committee Report[113].

The potential inconsistency between the current legal position and the concordat remains. How this will be resolved, however, remains unclear although this paper believes that a statutory public benefit test is not the solution for the reasons given above.

How will the Charity Commission apply the public benefit test in practice?

The combined effect of the abolition of the presumption and the advent of the concordat will mean that the Commission must carry out public benefit checks on currently registered charities. The Commission has said in its evidence to the Joint Committee that it will start with fee-charging charities, and most probably the independent schools. There seems to be no commitment to carry out a comprehensive review, and this may be problematic. Can it, for instance, be reasonable or fair for some charities to be on (or removed from) the register pursuant to one test, while others remain on the register pursuant to another (less stringent) test? A description of the Commission's current position on this point is set out in Part C of the Annex to this paper.

Implications of loss of charitable status

As stated above, the implications of loss of charitable status are unclear and potentially complex. There may be significant adverse effects on independent schools in terms of trustee and tax liability, and operational viability. It is iniquitous that the position is not more certain for charities that may be adversely affected by the abolition of the presumption. The implications for these charities of the loss of charitable status should be neutral, except for the loss of charitable tax exemptions going forward. A more detailed assessment of this issue is set out in Part C of the Annex to this paper.

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[113] Paragraph 8, pages 6 and 7.

CHAPTER 4

THE ROLE OF THE CHARITY COMMISSION IN THE NEW REGIME

At present, the Charity Commission regulates most charities, and maintains a register of registrable charities, of which there are currently about 188,750[114]. The Commission has four offices, in London, Liverpool, Taunton and Newport, and employs some 675 staff. Evidence given by the Home Office to the Joint Committee suggests that the cash budget for the Commission in 2004-05 is £29 million, with an anticipated 6% rise in 2005-06 to a plateau of £31 million until 2008[115].

The Commission has a dual function. On the one hand its role is to regulate registered charities pursuant to the requirements of the Charities Acts 1992 and 1993; on the other hand, it also has an advisory role[116].

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[114] In its annual report and accounts for 2003/04 the Commission states that there were 188,739 registered charities as at 31 March 2004. The report and accounts also suggest that the total annual income of the main registered charities (i.e. charities that are not subsidiary charities) in 2003/04 exceeded £32 billion (which accords with the Charities Aid Foundation figures – see above); and the estimated value of the total assets of registered charities was over £75 billion. In 2003/04 the Commission was responsible for the regulation of some 1.1 million charity trustees.

[115] Joint Committee Report, paragraph 212.

[116] This dual role is a cause for concern. See below.

The Bill creates a new body corporate to be known as the Charity Commission for England and Wales[117]. It sets out a series of regulatory objectives for the Commission[118]:

- increasing public trust and confidence in charities
- promoting awareness and understanding of the operation of the public benefit requirement
- increasing compliance by charity trustees with their legal obligations in exercising control and management of the administration of their charities
- promoting the effective use of charitable resources[119]
- enhancing the accountability of charities to donors, beneficiaries and the general public.

The Commission will have a series of functions by which it will carry out its objectives[120]. These functions are:

- determining whether institutions are, or are not, charities
- encouraging and facilitating the better administration of charities
- identifying and investigating apparent misconduct or mismanagement in the administration of charities and taking remedial or protective action in connection with misconduct or mismanagement
- determining whether public collections certificates should be issued, and remain in force, in respect of public charitable collections
- obtaining, evaluating and disseminating information in connection with the performance of any of the Commission's functions or meeting any of its objectives (including the maintenance of an accurate and up-to-date register of charities)

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117 S6(1)/1A(1). This replaces the old regime of an unincorporated body of Charity Commissioners under the Charities Act 1993.

118 S7/1B(1) - (3).

119 The wording in the draft Bill proposed an objective in this context of "enabling charities to maximise their social and economic impact". This met with considerable resistance, and the existing objective under the Charities Act 1993 has been retained. Objections to the "social and economic impact" wording included concerns that charities need not necessarily create social or economic impact in order to be effective. For instance, a conservation charity might need only to create an environmental impact to fulfil its objectives. Recommendation 13 of the Joint Committee Report recommended that the 1993 Act wording be retained, and this was adopted by Government in its Reply to the Joint Committee Report (Paragraph 13, at page 8).

120 Charities Bill, S7/1C.

- giving information or advice, or making proposals, to any Minister of the Crown, on matters relating to any of the Commission's functions or meeting any of its regulatory objectives including complying, so far as is practicable, with any request made by a Minister of the Crown[121] for information or advice on any matter relating to any of its functions.

The Commission also has a series of duties[122]:

- so far as reasonably practicable the Commission must, in performing its functions, act in a way which is compatible with its objectives and which it considers most appropriate for the purpose of meeting those objectives

- so far as is reasonably practicable the Commission must, in performing its functions, act in a way which is compatible with the encouragement of all forms of charitable giving and voluntary participation in charity work

- in performing its functions the Commission must have regard to the need to use its resources in the most efficient, effective and economic way

- In performing its functions the Commission must, so far as is relevant, have regard to the principles of best regulatory practice (including the principles under which regulatory activities should be proportionate, accountable, consistent, transparent and targeted only at cases in which action is needed)[123]

- in managing its affairs the Commission must have regard to such generally accepted principles of good corporate governance as is reasonable to regard as applicable to it.

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[121] It was argued in Grand Committee (See for instance, per Lord Hodgson (Hansard (Lords), 23 February 2005, from column GC287) that there should be an additional function of "facilitating development of and innovation in the charitable sector". The view was expressed (per Lord Swinfen, supra, column GC289) that this amendment was needed because "we do not wish the Charity Commission to be stuck in the mud like a Middle Ages cart". With respect, it ought not to be the Commission's function – as regulator – to facilitate these things, except to the extent of offering fair, reasonable, proportionate and efficient regulation and advice. It should be the objective of other charities – such as, for instance, NCVO so to facilitate. Such objectives would almost certainly be charitable under the purpose of promoting the efficiency and effectiveness of charities (Charities Bill, S2(2)(e) and S2(3)(c)(ii)); and if they are not, then steps should be taken to ensure that they are.

[122] Charities Bill, S7/1D.

[123] This duty was not included in the original Bill, and its inclusion is a considerable concession by Government. An analysis of the arguments around the inclusion of this Section is set out below in this Chapter.

Finally, the Commission has an incidental power to do anything which is calculated to facilitate, or is conducive or incidental to, the performance of any of its functions or general duties[124].

This is the first time that the obligations of the charity regulator have been set out in such detail in statute[125].

Despite this "modernisation" of the Commission's structure, there remains a number of important concerns relating to the Commission's capacity, accountability and role within the new regime.

Capacity

The Commission already has a difficult job regulating the nearly 189,000 registered charities and assessing the numerous annual applications for charitable status in accordance with the requirements of the Charities Act 1993.

The Bill will almost certainly impose a considerably enhanced workload on the Commission. And it is possible that insufficient consideration has been given to this in the Regulatory Impact Assessment accompanying the Bill**.** Granted, there appears to be a 6% uplift in the Commission's budget for 2005-2006[126], but given the increased responsibilities of the Commission discussed below, there must be a case for examining this question further and in more detail.

The costs of the Commission's enhanced regulatory role as a result of the Bill must also be considered in the light of Government's initiative to obtain

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[124] Charities Bill, S7/1E. The phrase "or general duties" was not included in the original Bill. Subject to certain exceptions, the Commission cannot, however, exercise functions corresponding to those of a charity trustee in relation to a charity or otherwise be directly involved in the administration of a charity.

[125] The Charities Act 1993 sets out the powers of the Charity Commissioners in that instance; but their remit is much briefer. S1(3) of that Act states that "The Commissioners shall (without prejudice to their specific powers and duties under other enactments) have the general function of promoting the effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matter affecting the charity and by investigating and checking abuses". By S1(4) the Commissioners are obliged so to act in the case of any charity "as best to promote and make effective the work of the charity in meeting the needs designated by its trusts".

The current duties and functions of the Commissioners are set out in S1 of the Charities Act 1993. There is considerable support for maintaining the status quo in this regard. The Commission's current duties are:

"1(3) The Commissioners shall (without prejudice to their specific powers and duties under other enactments) have the general function of promoting the effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matter affecting the charity and by investigating and checking abuses.

1(4) It shall be the general object of the Commissioners so to act in the case of any charity (unless it is a matter of altering its purposes) as best to promote and make effective the work of the charity in meeting the needs designated by its trusts; but the Commissioners shall not themselves have power to act in the administration of a charity."

[126] Joint Committee Report, paragraph 212.

savings as a result of the 2004 Gershon Review[127]; and the Commission itself appears concerned by this. For instance, in its report on Charity Working at the Heart of Society – The Way Forward 2005-2008[128], the Commission states that:

> "…How we operate over the next three years will also be influenced by our 2004 spending review settlement of £31 million until 2008. The implication of this is a decline in the real-terms value of our funding of approximately 2.5% in each of the next three years".

This concern was picked up by the Joint Committee when it recommended[129] that:

> "The evidence we have heard has given us reason to question whether the Charity Commission is properly organised and properly resourced to make it effective in its new tasks. We recommend that professional advice be sought to review the ability of the Charity Commission to meet its new responsibilities under the draft Bill and in particular the quality of the processes, methods and organisation; the calibre of its staff; its resources; and whether the Commission should, like other regulators, be able to determine the number and conditions of its own staff[130]."

In its report on Charity Working at the Heart of Society (see above), the Commission proposes a framework within which it will structure its new responsibilities under the Bill. It would be unfortunate, however, if the Commission was unable properly to apply the Bill or its proposed new structure because either of a shortfall in funding, or improper provisions in the Bill itself.

The Commission's enhanced workload will include the following:

1. *Reviewing the Register of Charities to consider whether the public benefit test is being complied with*

   The issue of the abolition of the presumption of public benefit has been dealt with in detail in Chapter 3. The issue is considered here only in the context of the Commission's capacity to carry out whatever public benefit checks will be required in future to apply the public benefit test to all charities reasonably, fairly and proportionately.

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127 Releasing Resources from the Frontline: Independent Review of Public Sector Efficiency, Sir Peter Gershon CBE, July 2004. See Chapter 7 below.

128 Published on 23 March 2005.

129 The Joint Committee had only the benefit of a draft Regulatory Impact Assessment in relation to the draft Bill. The final Regulatory Impact Assessment issued in May 2005 runs to some 140 pages.

130 Joint Committee Report, paragraph 215. This concern was taken up in the Bill's second reading in the House of Lords on 20 January 2005. See, for instance, Lord Sainsbury, Hansard, 20 January 2005 at Column 902.

There is a strong argument that, to ensure a fair, reasonable and proportionate application of the public benefit test once the presumption of public benefit is abolished and the Home Office/Commission concordat is applied, a comprehensive review of the register will be needed.

Although the Regulatory Impact Assessment for the Bill published on 18 May 2005 does not include any specific figures for the cost of a public benefit review[131], in its evidence to the Joint Committee[132] the Commission estimated that this process would imply a one-off cost of £250,000 and an annual cost of £250,000 thereafter. This is, however, presumably based on the "problem cases" approach[133], rather than a comprehensive rolling review.

In either case this will mean considerably enhanced workload for the Commission. Will there be sufficient budget and adequately trained staff to fulfil this function? On what basis will the Commission set about a coherent review of the Register? How will the Commission ensure that any such review is both lawful and even-handed? Will the registration process be slowed yet further[134] as a result of the fact that all applicants must demonstrate public benefit? Will the Commission develop publicly available Official Guidance encapsulating a series of coherent criteria to assist its staff in the public benefit assessment process?

The Joint Committee asked the Charities Minister in evidence if the Commission was "fit for purpose which can offer the efficiency that regulators in other areas do". The Minister's response was that "I do not think we are there yet but with the changes the Bill sets out…we will be there"[135].

The Bill itself does not stipulate any improvements in capacity, infrastructure or skills of the Commission. It is crucial that Government recognises that these issues must be addressed *before,* and not *after,* the Bill comes into force.

2. Regulating the Charitable Incorporated Organisation

Another key proposal in the Bill is the creation of a new form of incorporated body designed specifically for charities called the

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131 This figure was not included in either of the draft Regulatory Impact Assessment or the Regulatory Impact Assessment for the original Bill.

132 Report of the Joint Committee, paragraph 209.

133 See Part C of the Annex to this paper on how the Charity Commission will apply the public benefit test in practice.

134 The process is already slow: the Commission's KPI for average registration in 2003/04 was 88 days.

135 Joint Committee Report, Ev 305, Q1013.

Charitable Incorporated Organisation or "CIO"[136]. This body would confer limited liability on its trustees in the same way as the company limited by guarantee (CLG), a pre-existing incorporated form conferring limited liability which is already available to charities under the Companies Acts.

The main benefit of the CIO over the CLG will be that there will no longer be dual regulation under the Companies Acts and the Charities Acts, as is currently the case with the CLG. In practice, however, dual regulation rarely creates significant problems or substantial extra work for charities, and in most cases the additional cost of dual regulation is marginal.

The success or failure of the CIO will depend ultimately upon secondary legislation. A first draft Statutory Instrument[137] relating to the CIO was published by the Home Office on 19 January 2005. In the light of these draft Regulations, it is not automatically clear what substantial advantage the CIO is to have over the CLG[138]. Moreover, Government appears to accept that the evolution of this legislation will be imperfect. For instance, in the explanatory notes to the Bill it stated[139]:

> "… The Bill sets out the basic framework for the CIO. Further technical provisions, which may need amendment in the light of experience of the CIO's operation will be contained in secondary legislation. An exposure draft of the relevant secondary legislation is available on the Home Office website…".

Despite the publication of the new draft Regulations, therefore, the full utility and effectiveness of the CIO as an alternative to the CLG is not yet clear[140].

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136 See Charities Bill, S32 and Schedule 6.

137 The draft Charitable Incorporated Organisation Regulations 2005. These Regulations have provisions about minimum constitutional requirements for CIOs; winding up and insolvency of CIOs; dissolution of CIOs; restoration of CIOs to the Register; administration of CIOs; procedures for CIOs; execution of documents by CIOs; delegation and the appointment of nominees and custodians; authentication of documents relating to a CIO; electronic communications; application of the charity registration provisions of the 1993 Charities Act to the registration of CIOs; and appeals against decisions of the Commission relating to CIOs.

138 One of the most regrettable aspects of the CIO is that it fails to address one of the key concerns of Private Action Public Benefit – A Review of Charities and the Wider Not-for-Profit Sector (Cabinet Office, September 2002) that the CLG had a dual trustee/member structure where trustees and members are the same (paragraph 5.43). This does not appear to have been addressed in the draft Regulations.

139 At paragraph 126.

140 There is the possibility of a plethora of secondary legislation about the regulation of CIOs under the Bill. The draft Charitable Incorporated Organisation Regulations 2005 have already been published. Regulation is possible under the following provisions of Schedule 6: S69L in respect of winding up, insolvency and dissolution; S69O with respect to the administration of CIOs, and in relation to CIOs generally; Schedule 5A, Section 9(2) about the duties of trustees; and Schedule 5A, Section 13 about the procedure of CIOs. While many of these issues appear to have been dealt

Neither is it clear whether the CIO will eventually be a mandatory substitute for the CLG, or whether the CIO will be an alternative form although Government has agreed to review the need for other legal forms five years after the date of introduction of the CIO[141].

To date the price to be paid for limited liability has been, quite properly, regulation under the Companies Acts as well as under the Charities Acts. The Companies Acts are tried and tested legislation that properly regulate incorporated bodies with limited liability. Why is it necessary to create a new incorporated body with the accompanying necessary swathe of new regulation?

Will the Commission have enough staff properly to fulfil this additional regulatory function? What added value will the proposed new regime actually achieve? Is that worth the cost of setting up the CIO and the incremental cost to the Commission in regulating it[142]?

The final Regulatory Impact Assessment states[143] that the CIO will involve "additional burdens to the Commission but their figures indicate that it should be possible to absorb any costs in registering this new legal form". Is Government sure that this is the case? Has Government properly evaluated the costs of ongoing incremental regulatory aspects of the CIO once it is registered?

Equally, the final Regulatory Impact Report is silent as to the costs to Government of implementing the CIO. These should be published.

A new cost benefit analysis should be carried out in respect of the CIO to determine the need for, and propriety of, its introduction.

3. Other new powers and obligations

There is a considerable number of other powers and obligations proposed in the Bill that will further enhance the Commission's

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with in the draft Charitable Incorporated Organisation Regulations 2005, the Bill provides potential for yet further regulation.

141 See for instance Explanatory Notes to the Bill, paragraph 125; from Modern Company Law: Final Report, paragraph 4.63.

142 There will be considerable scope for enhanced workload under the new CIO regime. Taking one example, Schedule 6 of the Bill includes a new Part 8A, S69B(5) which states that "a CIO's constitution shall be in the form specified in regulations made by the Commission, or as near to that form as the circumstances admit". One can only imagine the lively and protracted debates between the Commission and applicants about what may and may not be appropriate deviations from the regulatory constitution, and what affect the relevant circumstances might legitimately have, once those circumstances have themselves been determined. Adverse decisions can be appealed to the Charity Appeal Tribunal under Schedule 4 of the Bill.

143 At Chapter 2 paragraph 1.55, page 18.

workload, most notably in respect of regulation around public collections[144] and the proposed new Charity Appeal Tribunal (CAT)[145].

Equally, the new work around the regulation of exempt and excepted charities contemplated under the Bill is likely to impose a considerable workload[146].

Has the impact of these been adequately anticipated, costed and budgeted?

The draft Regulatory Impact Assessment for the draft Bill appeared to gloss over many of these important issues. The final Regulatory Impact Assessment appears much more thorough, although it is of course neither appropriate nor possible for this paper to evaluate it either fully or accurately[147].

More worryingly, Government appears to accept in its Reply to the Joint Committee Report[148] that the evolving nature of the regulatory environment may mean that it is not possible even for Government currently fully or accurately to evaluate the ongoing costs of regulation:

> "The changes that the Bill will make, and other changes such as the move to providing services on-line, will require the Commission in some areas of its work to adopt new approaches to, and methods of, regulation. In recognition of this, the Commission's new Chair and its new Chief Executive have begun a strategic review of the Commission, to be completed by July 2005 and to report to the Chief Secretary to the Treasury. The Government believes that the Commission's strategic review, which could be professionally-advised, should be expanded to cover the matters… identified by the Joint Committee".

Leaving aside arguments about the wisdom of finalising a Regulatory Impact Assessment before such a review has been completed, Government must ensure that it expands the budget, capacity, staff and skill of the Commission to ensure it is capable properly, efficiently, reasonably, proportionately and fairly to carry out its enhanced functions as contemplated by the Bill. If it does not, then a series of new laws may be enacted that may be inefficiently and badly applied.

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144 See Part 3, Chapter 1 of the Bill.

145 See below.

146 The Regulatory Impact Assessment for the Bill published on 18 May 2005 estimates that the provisions of the Bill will attract the following costs for the Commission: in respect of exempt charities one-off registration costs of between £546,000 and £1,014,000 and continuing costs of £220,000 and £408,500; and relating to excepted charities one-off registration costs of between £350,000 and £650,000 and continuing costs of between £137,962 and £256,214.

147 One assumption that the Regulatory Impact Assessment may have made is that smaller charities will require only a "light touch" regulatory environment. The Big Lottery Fund scandal in November/December 2004, however, demonstrates that this is not necessarily a sensible course, and that misappropriation by even the smallest charity can materially adversely impact on public confidence in the sector as a whole.

148 At paragraph 21, page 11.

Accountability

The attempts in the Bill to increase the accountability and transparency of the Commission are to be welcomed. Recent legislative developments such as the Freedom of Information Act 2000, and executive initiatives by the Commission such as its rolling programme of publishing some of its internal Official Guidance, have all increased its accountability.

Nevertheless, there remains a general sense that the Commission is not sufficiently accountable to the sector[149], and this impression must be pro-actively addressed in the Bill.

1. Accountability to Parliament

Accountability to Parliament is re-enforced on the new Commission by a requirement to make a report to the Secretary of State on the discharge of its functions, the performance of its general duties[150], the management of its affairs and the extent to which, in its opinion, its regulatory objectives have been met[151]. Each report is to be laid before Parliament and published. This is a welcome enhancement to the obligations of the old Charity Commissioners under the 1993 Charities Act[152]. The Joint Committee has recommended that each parliamentary report should also be debated in Parliament.

2. Public Accountability

On the question of public accountability, matters are less clear-cut. One welcome innovation of the Bill is that the Commission must annually hold a public meeting for the purpose of enabling the report to the Secretary of State to be considered[153]. However, it is not clear what redress an aggrieved member of the public may have in respect of a matter arising from a report.

The Commission is subject to investigation by the Parliamentary Commissioner under the Parliamentary Commissioner Act 1967. An aggrieved member of the public through an MP could therefore request the

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149 See, for instance, Joint Committee Report, paragraphs 188 to 190.

150 The obligation for the Commission to report on its general duties was not in the original Bill. This was pointed out in the Grand Committee by Lord Phillips, who argued that "duties" should be added. Government undertook to give these arguments due consideration and the inclusion of the obligation to report on duties in the Bill is welcome, since it seems important for the Commission to report – even if subjectively – on the way in which it believes it has discharged its duties. Arguably, the obligation to report will also encourage the Commission to develop some measurable and objective key performance indicators in this regard.

151 Charities Bill, Schedule 1, Section 1/Schedule 1A, Section 11.

152 Charities Act 1993, S1(5). The Joint Committee Report emphasises that the Commission will also be subject to annual National Audit Office audit; periodic value for money examinations by the National Audit Office and the Public Accounts Committee; and the giving of oral or written evidence to the departmental select committee responsible for monitoring the expenditure, policy and administration of the Home Office.

153 Charities Bill, Schedule 1/Schedule 1A paragraph 12.

Parliamentary Commissioner to investigate the Commission – for instance, in relation to an issue in a report. The Parliamentary Commissioner is not, however, obliged to investigate in many cases[154]. As a result, it is not an attractive remedy.

It is not clear what, if any, other recourse members of the public can have if there is an issue of concern they wish to challenge arising from the report. Judicial review is a costly process with an uncertain outcome; and in any event it is a highly unsatisfactory mechanism to rely upon to hold a public body generally to account. As a result, public recourse seems to be largely political; and consideration must be given about whether this is satisfactory in the context of open government.

3. Accountability to the sector

There is a general understanding within the sector that more needs to be done to ensure that the Commission is held further to account to the public in general, and the charity sector in particular. For instance, the Joint Committee stated that "in taking oral evidence from the Charity Commission, we gained the impression that this was a body – unlike many others in receipt of public funds – which was unaccustomed to explaining its workings in public"[155].

One way in which the Joint Committee suggested that accountability to the sector might be enhanced is that there should be an express requirement on the Commission to act at all times proportionately, fairly and reasonably[156]. This obligation was not included in the original Bill. Government, however, initially objected to this[157] on the basis that this was already a duty of the Commission under administrative law and that to include it might suggest that other public bodies that were not constituted with such an obligation might not be under this duty[158]. It would seem unlikely that the relevant general duty under administrative law would be adversely affected by the imposition of an

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[154] The Parliamentary Commissioner is not obliged to investigate except in cases of maladministration, and cannot in any event investigate any action in respect of which the aggrieved party has a right of appeal or any legal remedy unless the Commissioner is satisfied that it would not be reasonable to expect the aggrieved person to resort to that appeal or remedy. This might include judicial review, for instance.

[155] Joint Committee Report, paragraph 185.

[156] Recommendation 15, at paragraph 169.

[157] See Government's Reply to the Joint Committee Report, paragraph 15, at page 9.

[158] It was suggested in Grand Committee that this concern might be overcome by the Minister making a statement that the inclusion of a reasonable, fair and proportionate principle was not intended to affect other legislation, so that on the so-called Pepper v Hart principles (Pepper (Inspector of Taxes v Hart and related appeals [1993] 1 All ER 42) the Minister's statement could be taken into account when interpreting the legislation. This paper believes that this is not a tenable approach for two reasons: first, the Minister's statement could hardly be said to validly affect *any* legislation, only the legislation directly in issue (i.e. the Charities Bill); and secondly, the Pepper v Hart principles only apply if the legislation in issue is ambiguous or obscure or the literal meaning led to an absurdity, which would have been unlikely to be the case here.

express statutory duty on the Commission; so it would not appear to undermine the common law position for other public bodies[159].

It was also initially argued by Government in Grand Committee[160] that this duty was not needed on the face of the Bill because the Commission already adheres to the five principles of the Better Regulation Task Force[161] which it applies in its publication The Charity Commission and Regulation. With respect, adherence to these principles is not in itself obligatory as a matter of law, and the Commission might derogate from them with impunity at any moment.

Furthermore, it is important from the perspective of the proper effectiveness of the Charity Appeal Tribunal (CAT) that an obligation for the Commission to act fairly, reasonably and proportionately appears on the face of the Bill so that the CAT can be reminded about taking such issues into account when making decisions.

Government has now largely conceded this point, so that the Commission must, so far as is relevant, have regard to the principles of best regulatory practice (including the principles under which regulatory activities should be proportionate, accountable, consistent, transparent and targeted only at cases where action is needed)[162].

It is unfortunate that Government has not adopted the Joint Committee's proposals and included the concepts of "fairness" and "reasonableness" in this provision; although, arguably, these are implied in the concept of proportionality in any event.

Equally, it might be argued that this duty should extend automatically to all cases (as with S3(3) of the Communications Act 2003) rather than only "where relevant"; and the current drafting begs the question about when the application of the principles will be relevant.

Nevertheless, despite these reservations, this paper suggests that the inclusion of this new duty on the Commission is a welcome advance, which will serve to bolster the sector's confidence in the Commission.

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159 Indeed Government has adopted the model suggested by the Joint Committee in other legislation. For instance, Section 3(3) of the Communications Act 2003 states that "In performing their duties… OFCOM must have regard in all cases to (a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and (b) any other principles appearing to OFCOM to represent the best regulatory practice". This accords with the five principles of good regulation set down by The Better Regulation Task Force, the independent body established in 1997 to advise Government on action to ensure that regulation and its enforcement accord with the five Principles, which are proportionality, accountability, consistency, transparency and targeting.

160 Per Lord Bassam, Hansard (Lords), 23 February 2005, column GC305.

161 See footnote above.

162 Bill, S7/1D(2)4.

4. Enhanced transparency for the sector's benefit

This new requirement will impose a welcome obligation of transparency on the Commission. This should be encouraged and sustained, since it will increase the sector's confidence in the Commission as a regulator. Furthermore, if the Commission is not transparent, then its adherence to its functions, duties and the principles of best regulatory practice cannot easily be ascertained.

The Commission does already attempt to court transparency. For instance, transparency is one of the key principles for the Charity Commission in its regulation of the sector, as set out in its publication "The Charity Commission and Regulation". Equally, the Commission will be subject to the requirements of the Freedom of Information Act 2000, so that it is now subject to the "right to know" and the "duty to confirm or deny" under that Act[163]. There are, however, numerous absolute and qualified exemptions from the right to know that are at times subject to calls of judgement by the Commission, so that, while an extremely welcome tool for transparency, adherence to the Act by the Commission cannot be guaranteed to deliver the transparency that might be expected of it by the sector.

Equally, the Commission is subject to the Code of Practice on Access to Government Information, published in 1997. While extremely welcome, this again has an analogous list of specified exemptions to those in the Freedom of Information Act. Redress under the Code's provisions is also unattractive, and lies primarily under the Parliamentary Commissioner Act[164].

The Commission has in any event initiated a process of publicly publishing some of its internal Official Guidance – again a welcome development.

Finally, the Commission has opened some of its Board meetings to the public[165].

5. Accountability to charities and users of the Commission's services

A person who has a grievance in respect of the Commission's standards of service can make a complaint in accordance with the Commission's complaints procedure, with ultimate redress to the Commission's Independent Complaints Reviewer[166]. This is, of course, an internal procedure, and if the

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[163] There will of course potentially be significant additional administrative costs and burden to the Commission in fulfilling its obligations under the Freedom of Information Act. Redress under the Act is first to the Information Commissioner, and then to the Information Tribunal.

[164] See above.

[165] Details are available from the Commission's website at www.charity-commission.gov.uk.

[166] The latest published version of the Commission's complaints procedure was published in October 2004. The procedure differs according to whether a complaint concerns dissatisfaction with standards of service or dissatisfaction with a decision. Broadly, the process in relation to service standards dissatisfaction is: make complaint within six months to Customer Service Manager (CSM); CSM issues report on complaint; escalate to Head of Customer Service within one month after issue of CSM report; escalate to Independent Complaints Reviewer within six months after

aggrieved person does not obtain satisfactory redress, currently further redress lies with judicial review to the High Court or resort to the Parliamentary Commissioner Act. None of these remedies is easy or attractive; and judicial review is expensive.

Charity Appeal Tribunal

One way in which the Bill seeks to enhance the accountability of the Commission to those directly affected by its decisions if not the sector generally, is to introduce a Charity Appeal Tribunal (CAT). This is a welcome development, and there is a considerable number of matters within the remit of the CAT[167].

In the explanatory notes to the Bill[168], Government asserts that the CAT will be "a new tribunal to act as the "court of first instance" for appeals and applications in respect of certain decisions of the new Charity Commission". The Bill, however, permits appeals to the High Court from the CAT, but on points of law only[169], so that on factual questions it will be rather the "court of last instance".

This is despite the fact that appeals can be made on issues of fact in certain circumstances from many lower Courts to the High Court[170]. Even the High Court can have its judgements appealed to the Court of Appeal on issues of fact in certain circumstances[171]. There is no reason why the decisions of the CAT should not be subject to appeal on certain factual issues to the High Court.

This is particularly the case where some of the most contentious decisions of the CAT will relate to factual determinations about public benefit which in some cases might result in the removal of organisations from the register. If

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Commission final response to complaint. The Independent Complaints Reviewer cannot review final decisions of the Commission, but can look into ways that decisions were taken. Further redress lies with the Parliamentary Commissioner or judicial review.

Broadly, the process in relation to dissatisfaction with a decision is: formally request a review in writing to CSM within three months after decision; CSM agrees with or rejects review; escalate to Legal Commissioner if requested within one month after the date of the letter from CSM rejecting the review.

167 See Charities Bill, Schedule 4. Appeals may be made under S1 of Schedule 4 and a list of some fifty one appealable matters is set out in a table to the Schedule. A narrower list of some seven reviewable matters is set out at S3 to the Schedule. The list of appealable matters can be amended by the Secretary of State under S6 of the Schedule pursuant to the affirmative procedure. The draft Charitable Incorporated Organisation Regulations 2005 published by the Home Office on 19 January 2005 propose some ten further appealable matters (S14). There are also about eight further appealable matters that can be referred to the CAT relating to public charitable collections pursuant to S55 of the Bill.

168 At paragraph 42.

169 Bill, S8(1)/2C(1).

170 See, for instance, County Court Act 1984, Ss78-84 (as amended).

171 See, for instance, Practice Direction Appeals (2001) PD52; Civil Procedure Rules, Part 52, January 2004.

Government is serious about improving the accountability of the sector, then it will consider amending the Bill so that factual appeals to the High Court are permitted in certain circumstances.

There are other concerns around the CAT:

Funding - In evidence to the Joint Committee[172], the Commission stated that the one-off costs and ongoing annual costs of the CAT would each be £200,000. The Joint Committee, however, cast doubt on the assumptions that had been used to reach these estimates[173]. The final Regulatory Impact Assessment for the Bill states that the Commission now estimates that its total costs for evaluating appeals would be between £444,000 and £602,400 each year – a significant increase from its estimates to the Joint Committee. Equally, Government should ensure that the assumptions made about the costs of the CAT itself are sufficiently robust. The final Regulatory Impact Assessment has estimated[174] about 125 to 180 cases each year with 275 to 630 sitting days. The Department of Constitutional Affairs has estimated that the CAT would attract on-going costs of between £700,000 and £1.4 million per annum, depending on case volume and complexity.

Clearly the CAT and the Commission must be adequately funded in this regard if the CAT is to comprise an appropriate device to facilitate accountability.

Financial assistance for appellants - The Bill makes no provision for paying the costs of those who appeal from a decision of the Commission to the CAT. This was highlighted as a considerable failing in the Joint Committee Report. Clearly the CAT can only be an effective accountability tool if it is accessible to all. So the Joint Committee's Recommendations at paragraphs 239 and 240 are to be welcomed as far as they go. They say:

> "We recommend that consideration be given to including in the Bill a residuary power for Ministers to make regulations enabling financial assistance to be given to parties to the Tribunal if it becomes apparent in the light of experience that access to the Tribunal is being limited by cost".

While some appeals to the CAT may be simple, others will certainly be more complex and require expert legal advice and representation. This will come at a cost – perhaps a prohibitive one. With respect to the Joint Committee, therefore, any residual power to make regulations enabling financial assistance should be expressed as a duty if evidence suggests that a material number of potential appellants are being denied access to the CAT on grounds of cost.

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[172] Joint Committee Report, paragraph 209.

[173] Joint Committee Report, paragraph 211.

[174] Chapter 2, paragraph 1.61 at page 20.

Government has rejected the Joint Committee's proposals here[175] arguing that legal representation is generally not necessary in the tribunal environment, and that in extreme cases either public funding can be granted exceptionally for representation under the Access to Justice Act 1999 or the Attorney General can intervene. Neither of these is an acceptable solution, and the complex nature of charity law and equity may mean that an appellant is disadvantaged by a lack of legal representation.

If Government is serious about the Commission's accountability and the accessibility of the CAT, it will facilitate financial assistance in the circumstances set out above[176].

Payment of Commission's costs by appellant – The regime currently contemplated by the Bill in respect of costs is:

- the CAT can order costs against any party to the proceedings (including in respect of the Commission's costs to be paid by the appellant) if that party has acted vexatiously, frivolously or unreasonably[177]

- the CAT can order the Commission to pay another party's costs if the CAT determines that a decision, direction or order of the Commission the subject of the proceedings was unreasonable[178]. In this context, orders against the Commission to pay another party's costs are not permitted unless the Commission's decision, direction or order was unreasonable (so that they would not be payable if the Commission's decision was wrong but not unreasonable for some reason)

- orders for compensation against the Commission for mal-administration in itself are not permitted.

This approach has a number of difficulties:

- While it is right that the CAT should be able to order costs against the Commission if it has acted unreasonably (since the Commission will be under an administrative duty to behave reasonably), this paper believes that it is wrong for the CAT not to have the power to award costs against the Commission where it has acted wrongly but not unreasonably. The fact that appellants might not be able to recover costs might deter them from bringing an appeal to the CAT on grounds that to incur the necessary expenditure with no prospect

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[175] Reply to the Joint Committee Report, paragraph 26 at page 12.

[176] S8(1)/2B(4)(i) entitles the Lord Chancellor to make rules about the practice and procedure to be followed in relation to proceedings before the CAT in the context of the award of costs. This would seem unlikley to be capable of extension to the award of financial assistance to appellants.

[177] S8(1)/2B(5)(a).

[178] S8(1)/2B(5)(b).

of recovery of costs might put them in breach of their fiduciary duties

- The ability of the CAT to award costs against an appellant should be restricted to circumstances where they have acted frivolously or vexatiously and not where the appellant has simply been unreasonable. Again, appellants might be deterred from bringing an appeal due to the perceived risk that if they lose their action in bringing the appeal might be interpreted by the CAT as "unreasonable" in any event

- The power to award costs against the Commission where the CAT considers that the relevant decision or order was unreasonable should be extended to cover breaches of the Commission's new general duty under S7/1D(2)4 of the Bill, where relevant.

Government's stance on this is particularly disproportionate since it has chosen not to act upon Recommendation 25 of the Joint Committee Report[179] which stated that:

> "We recommend that the Commission formally state that they will not seek to recover costs from an unsuccessful appellant (except where the Tribunal decides that the appeal amounted to an abuse of process)".

The Commission has refused to do this, but has instead stated that it "will not routinely ask for costs but the position would be very much governed by the facts of an individual case and the circumstances of the individual".

This is of little or no comfort to potential appellants and the prospect of having costs recovered against them does not encourage an accessible CAT. The matter should be appropriately addressed in the Bill. S8(1)/2B(4)(i) of the Bill entitles the Lord Chancellor to make rules about the award of costs, which provides some comfort, although it is unclear whether these rules could contravene the costs principles set out in the Bill described above[180] and this should be made clear on the face of the Bill.

Publication of Tribunal decisions – The Grand Committee raised the point[181] that it did not appear to be obligatory for the CAT to publish its decisions. There was a general view that this was essential, subject to taking necessary sensitivities into account. This paper supports that approach, and suggests that as a default position the decisions of the CAT should be published unless an order is made to the contrary[182]. This is most appropriately addressed in

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179 At paragraph 239.

180 S8(1)/2B(5).

181 Per Lord Hodgson, Hansard (Lords), 23 February 2005, column GC326.

182 On this point, provision should also be made that the Commission publicise its own decisions prominently and promptly when they are sufficiently important.

the rules regarding the CAT[183] which may be made by the Lord Chancellor under S8(1)/2B(2) which already contemplates the making of rules making provision "about the recording and promulgation of decisions"[184].

CAT to give reasons – Clearly if CAT decisions are to be coherent and appealable, then the CAT must promptly give reasons for them. This is not an obligation on the face of the Bill, and it should be[185].

Intervention of the Attorney General – Currently the Attorney General has power to intervene in certain charity proceedings[186]; and he may be an appellant in the proceedings of the CAT[187] in respect of reviewable and appealable matters. By S8/2C(3) the Attorney General is to be treated as a party to all proceedings before the CAT where there is an appeal to the High Court on a point of law against a decision of the CAT pursuant to S8/2C of the Bill[188]. The Attorney general may also bring proceedings of his own motion in relation to certain matters arising from public charitable collections[189].

The point was raised in the Grand Committee[190], however, about the fact that there are no circumstances where the Charity Commission or Attorney General might of its or their own motion and without intervention bring proceedings before the CAT, or indeed the High Court where the CAT does not have jurisdiction, on a general matter of charity law.

This paper does not support this approach with respect to the Commission having such a power:

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183 Although not subject to affirmative procedure.

184 S8/2B(4)(h).

185 Lord Phillips moved an amendment to this effect in Grand Committee: see Hansard (Lords), 23 February 2005, column GC326.

186 See, for instance, Charities Act 1993, S16 and S27. The Attorney General as "parent of the Nation" and guardian of the public interest is generally a necessary party to all claims relating to charities and in administration proceedings is a necessary party to represent the interests of the charity in question. With the permission of the Court of Appeal the Attorney General may appeal against a decision in proceedings to which he was not a party in the Court of first instance. See, for instance, Halisbury's Laws of England (4th Edition, 2001 re-issue), volume 5(2), paragraphs 31-38. An analogous power of appeal is conferred by S16(11) of the Charities Act 1993 in relation to matters relating to that Section.

187 Schedule 4/Schedule 1C, Section 1(2) in respect of appealable matters; and Schedule 4/Schedule 1C, Section 4(2) in respect of reviewable matters.

188 It was suggested in the Grand Committee (per Lord Bassam, Hansard (Lords), 23 February 2005, column S2D(4)) that the detail of process around the intervention of the Attorney General would be dealt with in the Lord Chancellor's rules for the CAT to be made pursuant to S8/2B(2) of the Bill. These are not yet available.

189 Bill, S55(4).

190 See, for instance, per Lord Hodgson (Hansard (Lords), 23 February 2005, column GC336) who moved an amendment that "In addition to the appeals and applications which may be made to the Tribunal pursuant to the provisions of Schedule 4 to this Act, the Attorney General or the Commission may of their own volition refer to the Tribunal such issues relating to the application of the law to charities as they may consider should be reviewed and determined by the Tribunal".

- the conflict of interest between the Commission as regulator and as representative of the charity sector dictates against it

- the CAT should be for resolving specific grievances about Commission decisions, directions or orders, and not for the Commission to develop and enforce regulation through interpretation.

With respect to the Attorney General having such a power, it is clear that the CAT, as a tribunal, has a limited remit to consider the decisions, directions and orders relating to specified appealable and reviewable matters. The CAT is not the correct forum to decide broader issues of charity law in general terms, or to raise questions about its ongoing interpretation, clarification, development and expansion. Such debates should be reserved for the High Court. The Bill should therefore empower the Attorney General to bring a general question of charity law and practice to the High Court for consideration of his or her own motion and without the need to intervene in proceedings. The Attorney General is in a much more impartial position than the Commission in this regard in his or her capacity of "parent of the Nation" with no direct interest in the regulatory environment.

Beddoe-style orders by the CAT – A charity might incur considerable expense in bringing a case to the CAT. Trustees might be held to be in breach of trust by having done so if they lost an appeal, and so potentially personally liable. It is currently possible in some circumstances for charities to obtain a "Beddoe" Order[191] whereby, before proceedings are brought and on the basis of the facts presented, the Court can by order protect the trustees from any personal liability arising from allegations of breach of trust arising from the proceedings.

The CAT currently does not have this power, so that theoretically any charity wishing to receive the benefit of a Beddoe Order must apply to the High Court before issuing proceedings in the CAT[192]. This is regrettable, and it would be unfair to deprive trustees of this protection in the CAT.

Appropriate provisions should therefore be included in the Bill to resolve this issue. It would not appear to be possible to leave this issue to the Lord Chancellor's rules contemplated for the CAT under the Bill, since S8/2B(2) of the Bill only empowers the Lord Chancellor to make rules regulating the exercise of rights of appeal or to apply to the CAT and the practice and procedure to be followed in relation to proceedings before the Tribunal.

Inexcusable delay by the Commission – Currently the CAT has no power to intervene in circumstances where there has been mal-administration by the Commission. In general this paper supports that approach, primarily because conceptually it should not be the place of the CAT to consider compensation

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[191] From the case of In re Beddoe (Downes v Cottam) [1892] B. 596.

[192] If a Beddoe Order was capable of extending to the CAT at all.

claims against the Commission. There must be occasions, however, where a charity's fulfilment of its objects and the interests of its beneficiaries are adversely prejudiced by the delinquent delay without good reason of the Commission to make a decision. In such a case the charity concerned should be able to make an application to the CAT for the CAT itself to make the decision. Clearly, of course, any such power should fall within the areas of competence reserved to the CAT within the appealable, reviewable and S55 matters in the Bill.

6. The Joint Committee's recommendations on accountability

The Joint Committee recognised that there was a general yearning within the sector for the Commission to be more accountable. After taking evidence on the subject, the Joint Committee recommended[193] that "there should be a greater number of people on the Charity Commission board with experience and knowledge of the charitable sector, in order to reflect its great diversity, particularly at grass roots level. This should be accompanied by adequate safeguards against conflicts of interest."

This Recommendation was adopted by Government[194] which stated that:

> "In proposing this increase the Government's aim is to secure the result that the Joint Committee advocates: greater and more diverse charitable sector representation on the Commission's board. We agree with the arguments advanced in favour of this to the Joint Committee, but we also note the Joint Committee's caution about the need to avoid "regulatory capture" of the Commission by the sector it regulates. Some of the potential benefits of a larger board would be lost if for that reason board members were required on joining the Commission to shed every one of their connections of charity employment or trusteeship. We are preparing guidelines, for future appointments to the board of the Commission, on an acceptable level of board members' continuing involvement with charities and on the avoidance of conflicts of interest".

This approach is to be welcomed. With respect, however, it seems unlikely that it will afford a solution to the question of general and overall accountability to the sector; although it would almost certainly be a good thing from the perspective of increasing the knowledge and understanding of the Commission about the sector, and of spreading the workload of the members of the Commission. Despite the implementation of procedures and safeguards for the management of conflicts of interest, once someone is a member of the Commission, his or her duty whilst acting in that capacity is to discharge the duties and functions of the Commission as set out in the Bill. So the Commission's accountability to the sector remains within the limited parameters afforded by law.

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[193] Joint Committee Report, paragraph 192.

[194] See Government's Reply to the Joint Committee Report, paragraph 19, at page 11.

This paper does not pretend to have the answer to enhancing the accountability of the Commission to the sector and the public in a proportionate and workable way – which furthers the accountability of the Commission to the sector as a whole without falling into the "regulatory capture" trap, which this paper accepts would be undesirable. More work needs to be done by Government on this issue however, because neither the proposals within the Bill nor those of the Joint Committee are satisfactory to make the Commission appropriately accountable to the sector and the public in the contemporary context, although the inclusion of the new general duty in respect of best regulatory practice goes a considerable way towards this[195]. And so the general perception that the Commission is not sufficiently accountable to them remains.

One of the problems with the commendable attempts to enhance the Commission's accountability is that they tend to be either confrontational (the CAT) or passive (reviewing reports or attending Board Meetings of the Commissioners). Perhaps a more consensual, interactive and pro-active structure is needed – for instance, a quarterly or bi-annual meeting between senior members of the Commission and senior members of the sector's key umbrella bodies such as NCVO, acevo and Volunteering England. In such a meeting the concerns of the sector could be considered in good faith by the Commission. This approach should be investigated.

Conflicting role

The Commission has a dual role of regulator of and advisor to charities. This is implied in some of the functions and objectives of the Commission set out in the Bill[196]. The advisory powers are covered expressly in S24 of the Bill, which amends S29 of the Charities Act 1993, where charity trustees can apply to the Commission for advice, which, if acted upon, can protect the trustees from any allegations of breach of trust.

There are two key difficulties here. First, the Commission is not obliged to give advice; and secondly, it is not clear where the Commission's advisory function ends and its regulatory function begins. As a result, there is a general concern that if one goes to the Commission for advice in relation to a difficult situation, the Commission may use the information given to it in its advisory capacity to commence an investigation under S8 of the 1993 Act in the exercise of its regulatory function.

Equally, a charity could apply for advice under S29, and the Commission could refuse to give that advice. As a result the charity will be in the invidious position of having given a full factual matrix of the circumstances to the Commission, receiving no advice, and then having to make up its own mind about what to do. The Commission, fully appraised, could then open a S8

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[195] Bill, S7/1C(2)2 and 5.

[196] See for instance Bill, S7/1B(3) paragraphs 3 and 4.

Investigation[197] if it did not like the outcome of the charity's chosen course of action.

Even the potential for such invidious eventualities is unacceptable and it seems very likely to have a chilling effect on the likelihood of charities approaching the Commission for advice[198].

This concern was re-enforced throughout the sector. For instance, Stuart Etherington Chief Executive of NCVO, explained to the Joint Committee[199] that:

> "I do not think anybody is against the Commission giving advice which is within their competency to give. What I think they need to be clear about and perhaps clearer about… is that they need to make it clear to charities, particularly the smaller charities, when they are giving advice and when it is a must-do because if you are not clear about that, the smaller charities will interpret advice by the Commission as a must-do and the potential creep if that is not always clear is enormous. …The Commission need to be absolutely crystal clear when they are advising trustees of when it is a must-do and when it is a good practice should-do".

There was considerable debate in the Private Action, Public Benefit consultation about how this should be dealt with. Possibilities include the hiving off of the advisory role of the Commission to an independent third party, such as NCVO; or the dividing up of the Commission into an advisory division and a regulatory division, with a Chinese wall between them to ensure that any information given to the Commission in its advisory function could not be used by it when exercising its regulatory role.

On balance, the latter approach is to be preferred. First, the Commission does not have an exclusive right to advise charities, so that organisations such as NCVO can continue to advise them in any event. Secondly, the strength of much of the advice from the Commission derives from the fact that it is regulator as well as advisor. As long as the conflict of interest is properly managed - for instance by the implementation of a "ring-fencing" Chinese wall - and the Commission adopts practices that make clear to charities when they are required to do something and when they should do something as best practice, then there is no reason why the Commission should not continue its advisory function.

The Joint Committee recommended[200] that the Commission "should take steps to differentiate between its advisory and regulatory functions and make

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197 Pursuant to S8 of the Charities Act 1993.

198 Although arguably the Commission, by behaving in this way, might have breached its proportionality obligation in S7/1D(2)4 of the Bill.

199 Joint Committee Report, Volume II, Ev12 at Q23.

200 Joint Committee Report, Paragraph 207.

clear in all its communications the distinction between advice and instructions." This Recommendation was adopted by the Government in its Reply to the Joint Committee Report. Government quoted the Commission's response to the Recommendation[201]:

> "The Commission will take… [this Recommendation] forward by reviewing its structure and communications to help trustees and their advisers recognise when the Commission's activities are directed specifically about compliance with their legal obligations and when the activities are advisory".

With respect, this does not deal with the key concern of the "differentiation" or "ring-fencing" of the Commission's regulatory and advisory functions. This issue is so fundamental to the confidence of the charitable sector in the Commission that the obligation for the Commission to do this should be expressly entrenched in the Bill.

Finally, the Commission should be obliged, and not merely empowered, to give advice when it is sought under S29 of the Charities Act 1993 (as amended by the Bill).

6. The composition of the Commission

There was considerable debate in the Grand Committee[202] about the number of members of the Commission and their time in office. This issue is crucial to the effective and efficient working of the Commission because:

- the number of members of the Commission affects the dynamics of the way it operates: too few members and there is a dearth of cross-fertilisation of expertise and experience; too many, and proceedings become unwieldy

- the duration of time in office of the members of the Commission also affects the dynamics of the way it operates: people need to be members for sufficient time to enable them to grow in experience, expertise, confidence and stature; but not so long that they become stale or block entry to someone who might be more useful. In the view of this paper, cutting short an appointment in its prime is a cardinal sin because it is a loss for ever: while typically, although inconvenient, a ""stale" appointee can be manoeuvred around[203].

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201 Government Reply to the Joint Committee Report, paragraph 20, at page 11.

202 See, for instance, Hansard (Lords), 10 February 2005, from column GC153.

203 This is reflected in the Combined Code on Corporate Governance (July 2003), which states at paragraph A3 that "the board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board'' composition can be managed without undue disruption" While on first blush this might not seem directly relevant, it should be remembered that one of the Commission's duties in managing its affairs is to "have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it" (see Bill, S7/1D(2)5.

The Bill provides that the Commission shall consist of a chairman and at least four, but no more than eight, other members[204]. This is a sensible approach and should be supported.

The original Bill provided, however, that an appointment of a person to hold office as a member of the Commission shall be for a term not exceeding five years[205]. The original Bill was silent as to whether they can be re-appointed.

This regime was replaced in the Bill with a maximum period of three years that can be increased by the Secretary of State by further periods of up to three years up to a maximum of ten years[206]. If any person is appointed chairman during their second or third three year period then their time in office may be increased so that they may remain in office for up to ten years in total. Typically, therefore, assuming a three year term, no-one may serve more than nine years except a chairman appointed in his or her third three years of tenure, who may serve up to ten years. If there are concerns about nine and ten years being too long, the scheme enables less suitable members to be replaced every three years (or potentially even less). Anyone who is appointed a chairman in their second or third period of office is likely to be an exceptional contributor to the Commission.

This paper supports this new scheme, since it enables members of the Commission to be flexibly refreshed every three years (or less) in accordance with their experience, contribution and attitude.

This scheme also satisfies the requirements of The Commissioner for Public Appointments Code of Practice for Ministerial Appointments to Public Bodies[207], which states[208] that "…the maximum period in office must not exceed ten years on the same board. Only in exceptional circumstances will the Commissioner agree an appointment term which extends the total service beyond the ten year limit".

The scheme also reflects guidance by the Combined Code on Corporate Governance[209] which provides some useful guidance in this regard that "all directors should be submitted for re-election at regular intervals, subject to

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204 Bill, Schedule 1/Schedule 1A, S1/1(1).

205 Original Bill, Schedule 1, S1/3(1).

206 Bill, Schedule 1/Schedule 1A, S3(1)-(5).

207 December 2003. The Commissioner's remit appears to extend to the Charity Commission pursuant to paragraph 1.02 of the Code since the Commissioner's role extends to a "non-departmental public body" and the Charity Commission is a "body corporate the functions of which shall be performed on behalf of the Crown" (see Charities Bill S6(1)/1A). Government regards the Commission as a Non-Ministerial Government Department (see below). Even if the Commissioner's remit does not extend to the Commission, the provisions of the Code ought to extend by analogy to the Secretary of State's deliberations in this regard.

208 At paragraph 3.12.

209 July 2003.

continued satisfactory performance[210]. The board should ensure planned and progressive refreshing of the board[211]. This is reflected in the charity context by NCVO in both its online guidance and in its Good Trustee Guide[212].

Independence of the Commission

The Commission is a body corporate[213] the functions of which are to be performed on behalf of the Crown. It is subject to the authority of the Secretary of State for the Home Office. As a result, the independence of the Commission was a key concern of the Grand Committee[214].

Lord Phillips moved an amendment that "the Commission shall be an independent public body, free of Government direction and control". In support of this he stated[215]:

> "… the Charity Commission wishes to have a more explicitly independent status under the Bill. The Chief Charity Commissioner, Geraldine Peacock, made it abundantly clear when some days ago she addressed all Peers who had an interest in the Bill. Richard Fries, who was the commissioner before John Stoker, is adamantly of the view that the commission, the Government and the sector would be better off if there were a more independent status for the commission…
>
> Why are they all concerned? It is broadly to do with the extent to which, in modern circumstances, charity is embroiled with the affairs of government and state… We know only too well that in modern circumstances the scope of political intervention… and certainly the scope of legislative intervention is at a height that our forefathers would not have thought possible".

Part of the problem arises from S6(1)/1A(3) of the Bill which states that the functions of the Commission shall be performed on behalf of the Crown. This, however, arguably implies an agency in favour of the Crown, with all the limitations on the independence of the agent that that entails. Furthermore, Government regards the Commission as a "non-ministerial Government Department"[216], which again implies a lack of independence from Government. The problem is also exacerbated because, as charities

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[210] See Combined Code, paragraph A7. While on first blush the Combined Code might not seem directly relevant, it should be remembered that one of the Commission's duties in managing its affairs is to "have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it" (see Bill, S7/1D(2)(5)). This paper welcomes the fact that Government has taken this opportunity to help to facilitate that on the face of the Bill.

[211] At paragraph A7.

[212] 2003 Edition.

[213] Charities Bill S6(1)/1A(1).

[214] See, for instance, Hansard (Lords), 10 February 2005, from column GC124.

[215] Hansard (Lords), 10 February 2005, column GC124.

[216] See below.

increasingly become involved in the delivery of public services for public bodies, the risk of Government self-interest in charity regulation increases.

Entrenching the independence of the Commission on the face of the Bill would resolve these problems and would be of considerable comfort to the sector generally. It would also guarantee the independence of the proper regulation of charities from day-to-day political imperatives.

This issue was earlier taken up by the Joint Committee Report which recommended at Recommendation 17 that the phrase "on behalf of the Crown" be replaced by a clear statement that the Commission shall be a body independent of Government. In its Reply, the Home Office stated that:

> "the Commission is, and will remain, a Non-Ministerial Department[217]. It is, and will remain, an independent regulator, completely free from any Ministerial direction or control over the exercise of its statutory powers to regulate charities. The Government believes that the Commission's independence in that respect is of paramount importance for the proper regulation of charities and for public confidence in charities."

Government mounted considerable resistance to entrenching the independence of the Commission in the face of the original Bill, and this caused considerable concern. The Bill, however, at last provides a new provision at S6(1)/1A(4) which states that "in the exercise of its functions the Commission shall not be subject to the direction or control of any Minister of the Crown or other government department"[218].

This paper supports this approach, while regretting that Government resisted this common-sense and re-assuring provision for so long.

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[217] In the Grand Committee debates Lord Bassam reiterated this position when he stated (Hansard (Lords), 10 February 2005, column GC139) that "the reference to the functions of the commission being performed "on behalf of the Crown" are necessary for technical reasons to ensure the commission's continued status as a non-ministerial department". In its Reply to the Joint Committee Report (paragraph 8, page 7) Government notes the concerns about guidance being issued by Government based on the principle that there should be no Government control over any aspect of the definition of charity. The Reply states that "To remove that risk we therefore intend in the Bill to place the guidance-making function not with the Secretary of State but with the Charity Commission as the independent regulator which is not under Government direction or control". While the provisions of S4 of the Bill are to be welcomed, the circumstances of the concordat suggest that the Commission's position on the public benefit test with regard to fee-charging charities continues to evolve in concert with the Home Office.

[218] As a semantic issue, is a "Minister of the Crown" himself or herself capable of comprising a "government department" as the drafting of this provision suggests?

CHAPTER 5

THE RISK OF EXCESSIVE REGULATION

It is right that the charity sector should be properly regulated. There is much at stake in the preservation of public confidence. There is a danger, however, in over-regulating the sector in the belief that regulation of whatever sort can only be a good thing in the charity context[219].

Proposals in the Bill

As an example of the tendency to over-regulate, S67 of the Bill proposes a reserve power to introduce regulation in relation to public fundraising. If such a reserve power is exercised, it should be exercised only very cautiously. It is arguably a knee-jerk reaction to the perceived problem of face-to-face fundraising, and should be recognised as such. Even the Home Office accepts that face-to-face fundraising is a concern of only 12% of those responding to a survey published in March 2004[220]. Equally, Stuart Etherington, CEO of NCVO said in his evidence to the Joint Committee[221] when asked if there had been a suggestion that some fundraising might be unacceptable, especially in relation to "bibbed street "muggers"":

> "I do not think there is a particular fundraising technique that has caused this issue to arise despite public statements around that".

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[219] This is a concern that was expressed in the original Bill's second reading in the House of Lords. See, for instance, Lord Phillips (Hansard (Lords), 20 January 2005 at column 906), when he said: "If I have an early morning panic about this Bill, it is that while, clause by clause, it may seem sensible enough, in totality it will turn out to beget yet another upward ratchet towards an over-managed, centralised, bureaucratic society".

[220] See Joint Committee Report, DCH 15, Memorandum from the Home Office, at paragraph 6.

[221] Joint Committee Report, Volume II, at Ev 25, Q97.

The reserve power set out at S67 entitles the Secretary of State to impose a good practice requirement on the persons managing charitable institutions where they are engaged in charity fundraising[222].

The "good practice requirement" is defined[223] as a requirement to take all reasonable steps to ensure that fundraising is carried out in such a way that it does not:

- unreasonably intrude on the privacy of those from whom funds are being solicited or procured
- involve the making of unreasonably persistent approaches to persons to donate funds
- involve the making of any false or misleading representation about the:
  - extent or urgency of any need for funds on the part of any charitable institution or company connected with such an institution
  - use to which funds donated in response to the fund-raising are to be put by the institution or company
  - activities, achievements or finances of the institution or company.

The issue of face-to-face fundraising

According to the Charities Aid Foundation, the top 500 charities in England and Wales spent £8.1 billion altogether in 2003, about 9% or £729 million of which was spent on fundraising.

Fundraising is a sophisticated business: gone now are the days when the rattle of the collection tin was the key weapon in the fundraiser's armoury. The modern arsenal includes direct marketing, on-line fundraising, international telethons, and now "face-to-face" fundraising.

The perception is that face-to-face brings negative thoughts to people's minds of being assailed by an army of fundraisers with clipboards obstructing every step of the way down the High Street: so much so that face-to-face fundraisers have been branded as "charity muggers" or "chuggers". As can be seen from the figures above, this perception is largely exaggerated.

There are several reasons why face-to-face is a positive thing. First, it gives those who might not otherwise have it exposure to charities and the work they

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[222] S67(3).

[223] By S67(4).

do; secondly, more explanation about a charity's work is given with face-to-face than with collecting tins; thirdly face-to-face can be cheaper than other forms of fundraising, such as cold mail, so enabling a charity to spend less on fundraising costs and more on good causes; and fourthly it has given a number of charities a new additional form of income. One household name charity estimates that in 2004 it received additional income of over £5 million attributable to face-to-face fundraising that will go towards the fulfilment of its charitable causes.

Some say face-to-face is declining because of the way it is perceived to abuse potential donors. That is not the case, however. In 2003 690,000 donors were recruited via face-to-face with a lifetime value of £240 million, more than in previous years. The face-to-face market is also growing faster in income terms than most other forms of direct marketing. Face-to-face also enhances access to 18-34 year old donors, who traditionally give proportionately less to charity than other groups; and the face-to-face donor profile is typically younger than "traditional" donors.

Nevertheless, Government intends keeping a watchful eye to see if the sector can be trusted to self-regulate in the fundraising context.

Possible self-regulatory models

The Institute of Fundraising, an umbrella body for fundraisers, has, with the support of the Public Regulatory Fundraising Association, taken responsibility for self-regulation and has worked up a face-to-face Code of Practice. It has also commissioned an independent commission – The Buse Commission – to make recommendations about acceptable self-regulatory structure. The Buse Commission has issued reports and recommendations in respect of Phase 1 and Phase 2 of its research[224], which begin to formulate a possible framework for self-regulation in fundraising. Meanwhile, it also seeks to persuade the Home Office to publish clear benchmarks against which the success or failure of self-regulation will be judged.

Any regulation under the statutory reserve power must be balanced and proportionate. One possible model for balanced and proportionate regulation is premium rate charged telephone services. The independent regulator – ICSTIS (or the Independent Committee for the Supervision of Standards of Telephone Information Services) - operates in a "co-regulatory" environment. ICSTIS is an industry-funded body that publishes a self-regulatory Code of Practice after industry consultation. Despite the fact the Code is independent of Government, it is given statutory teeth under S121 of the Communications Act 2003 that enable ICSTIS to impose fines, bans and restrictions on service providers who flout the Code.

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[224] Available from the Buse Commission website at www.busecommission.org.uk. Phase 1 Report, the Future of the Self- Regulation of Charity Fundraising – Objective and Scope, August 2003; Phase 2 Report, Proposed Framework and Governance Structure, January 2004.

On the other hand, the Buse Commission[225] has recommended that the Office of Fair Trading (OFT) self-regulatory framework be used as the basis for developing a self-regulatory framework for the voluntary sector. This would include the adoption of a public recognition symbol or logo mark for application across the voluntary and community sector for the use of all organisations that are part of the self-regulation scheme. Any Code of Best Practice would be mandatory for any members of the overseeing self-regulatory body or so-called Code "sponsors"[226].

The Buse Commission's recommendations were followed in November 2004 by the Steering Committee of the Institute of Fundraising which published a paper on the Self-Regulation of Fundraising[227] the aim of which was to construct a robust and participatory self-regulatory scheme in relation to fundraising techniques and activities which would constantly help to drive up standards and contribute to maintaining the confidence of the general public in charities.

This scheme contemplates the development of Codes of Practice, including a Donors' Code of Practice, that will be overseen by a Regulation of Fundraising Unit within the Institute of Fundraising. Membership would be voluntary and would be open to charitable, philanthropic and benevolent bodies, fundraising consultants and advisers and professional fundraisers. Members will be expected to adhere to the highest standards of fund-raising and the Codes, promote the scheme and submit to a sophisticated complaints handling regime.

The Steering Committee Report is currently with the Home Office for consideration.

Are these various proposals needed?

So these all might be ways forward. But is the state of public fundraising sufficiently iniquitous to need even this "soft" regulation? While superficially alluring, the ICSTIS analogy is not strong: many people do not know or understand when making a call that a premium charge is being levied. Donors signing up to face-to-face know exactly what they are doing. If you do not want to donate, exercise self-restraint. If you fill in a direct debit form, it can always be cancelled. Surely a charity engaging in face-to-face is entitled to assume that adults, unless somehow incapacitated, are capable of properly managing their own affairs?

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[225] The Future of Self-Regulation of Charity Fundraising (Buse Commission Phase 2 Report) – Proposed Framework and Governance Structure, at section 4.

[226] This is not the place for a detailed analysis of this issue, but a full description can be found in Section 7 of The Future of Self-Regulation of Charity Fundraising, Buse Commission Phase 2 Report – Proposed Framework and Governance Structure.

[227] "The Self-Regulation of Fundraising", a paper prepared by a Steering Committee of representatives from the Charities Aid Foundation, the Institute of Fundraising, the Public Fundraising Regulatory Association, NCVO, acevo, the Scottish Council for Voluntary Organisations, the Charity Law Association and the Charity Commission. Copies are available from the Institute of Fundraising's website.

Is a reserve power needed?

As for the reserve power, professional fundraisers are arguably already adequately regulated under the 1992 Charities Act, which requires transparency about fundraiser remuneration and a clear agreement with minimum contractual terms between the fundraiser and the charity[228].

For the rest, the market should dictate corrections: if face-to-face becomes abusive, then the public will not tolerate it and charities will stop using it. If particular professional fundraisers become too aggressive, then charities will prefer to hire others[229].

Nevertheless, the high standing of the charitable sector is to be protected and nurtured. It is easily damaged by high-profile frauds, or by a sense of unfair play or exploitation where fundraising is concerned. For this reason, on balance the Home Office is right to seek a reserve power – provided it is used sparingly and patiently, and in conjunction with published and well-publicised benchmarks against which the success or failure of self-regulation will be judged.

The Joint Committee's recommendations[230] in this regard are therefore to be welcomed. First, the Joint Committee states that it "supports the approach of encouraging effective self-regulation backed by the prospect of reserve powers if that is unsuccessful". Secondly, it recommends that "the explanatory notes published with the Bill set out more fully the criteria by which the Secretary of State will determine whether self-regulation is working effectively."

This reflects the evidence of Stuart Etherington to the Joint Committee when he stated[231]:

> "There was a big debate in the Strategy Unit report and the advisory group as to whether it [public fundraising] should be statutorily regulated or self-regulated. I think the sector realised it need to get its act together in relation to consumer redress in relation to fundraising techniques and bad practice where it exists, some of the third party fundraising activities, in order to maintain consumer confidence, but to encourage reserve powers if that failed. We need to be clear about how we would know it would fail."

The explanatory notes to the Bill do not include any criteria about this, which is disappointing. Nevertheless, in its Reply to the Joint Committee[232],

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[228] The regulation of professional fund-raisers is dealt with in Sections 59 to 62 of the Charities Act 1992 and in The Charitable Institutions (Fund-raising) Regulations 1994 (SI 1994/3024) made pursuant to S64 of that Act. S65 of the Bill amends S60 of the 1992 Act to make more precise the requirements about the statements that must be made by professional fund-raisers.

[229] There have already been a number of recent supply side adjustments in the face-to-face professional fundraiser market.

[230] Joint Committee Report, paragraphs 276 and 277.

[231] Joint Committee Report, Volume II, at Ev 25, Q99.

Government "made a commitment to publish an indication of these criteria by the time the Bill is debated in Parliament, and will then consult widely among fundraising charities and others before finalising the criteria".

As a result, the Charities Unit at the Home Office published a consultation paper on 14 March 2005 entitled "Principles for Assessing the Success of Self-Regulation of Fundraising". This paper welcomes this consultation.

Finally, the Joint Committee recommended[233] that the reserve power for the regulation of fundraising by charities should be subject to Parliament's affirmative procedure. As a result any regulations made under the reserve power would be subject to parliamentary scrutiny before adoption.

This Recommendation was ignored by Government in its Reply to the Joint Committee Report, and the reserve power in the Bill as it currently stands is not subject to the affirmative procedure[234].

This paper suggests that any regulations made under the reserve power should be subject to the affirmative procedure so that they may be scrutinised by Parliament before their adoption. If Government is satisfied that any regulations it proposes under the reserve power are fair and proportionate it can have little to fear from the affirmative procedure. Conversely, the impact on charities' fundraising income of disproportionate regulation argues strongly for the affirmative procedure.

The former Home Secretary has asserted[235] that the Bill creates "a modern legal framework which will enable the sector to operate in a dynamic and innovative fashion". If Government truly means what it says, with or without an affirmative procedure, it will leave the chuggers to it unless disaster genuinely looms.

The debate about the regulation of chuggers is just one example of where Government should forbear regulation if it truly has the interests of the sector at heart. A light regulatory touch overall is to be the preferred approach if the sector is to develop and flourish dynamically and with innovation. Over-regulation will spell the death-knell of a dynamic, innovative, effective and modern charity sector.

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232 Paragraph 32, at page 14.

233 Joint Committee Report, paragraph 403.

234 See Bill, S71(3) and (4).

235 In the foreword to Charities and Not-For-Profits: A Modern Legal Framework – The Government's Response to "Private Action, Public Benefit", Home Office, July 2003.

CHAPTER 6

RECOVERING IRRECOVERABLE VAT

There are a number of benefits to being a charity. Prominent amongst these are, first, the public respect, trust and confidence that being a charity attracts; and, secondly, the series of tax reliefs available[236].

One tax benefit is Gift Aid[237]. In respect of individuals' Gift Aid payments, the charity can reclaim the basic rate of tax to the extent the donor has paid basic rate tax, while the donor can reclaim the higher rate to the extent they are a higher rate taxpayer. Companies making payments under Gift Aid can make an equivalent deduction against tax. Gift Aid payments are an important source of income for charities. The Charities Aid Foundation has, for instance, calculated that in 2003 gross charity income from individual Gift Aid amounted to £2.46 billion. Of this, Government tax reliefs were worth £1.1 billion.

This is an impressive figure. But it is undermined by the fact that charities pay out at least an estimated £460 million annually in irrecoverable VAT. The UK VAT regime does not take account of the specific circumstances of non-trading charities. This is compounded by the fact that the EU VAT Treaties, which seek to harmonise VAT throughout the EU, also fail to take account of those circumstances.

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[236] See Chapter 2 above.

[237] See Finance Act 2000.

The VAT regime should not be an irrecoverable duty on non-trading charities. The issue is simple: charities that do not trade above the VAT threshold (currently £60,000[238]) or do not trade at all (of which there will be many), are not entitled to register for VAT, and so will be unable to recover the VAT on the products and services they purchase[239].

This is a widespread problem within the charity sector; and it seems invidious that charities should have to bear the burden of irrecoverable VAT so that, at the very least, it undermines the annual benefit of Gift Aid by about 42%.

This problem is one that must be addressed at an EU level, since it is true that the UK is obliged to adhere to the requirements of the EU VAT Treaties which make no concessions to charities. However, there seems little political will within Government to tackle this issue at the EU. There is a strong argument that charities should not be required to pay input tax on supplies that do not relate to their own VAT-able trading activities since the input tax would only relate to charitable operations[240]. Such a scheme could be applied even-handedly throughout the EU.

If Government is committed to maximising the effectiveness of the UK charity sector as it says it is, then it will quickly develop the political will to address this issue aggressively at the EU.

At the same time, or as an alternative, Government should address the issue domestically by "reimbursing" irrecoverable VAT paid by charities. This approach has been advocated by a number of influential bodies that have considered this issue, and would comprise a simple solution at an easily determinable cost to the Treasury[241].

To date Government has been inflexible in this regard: but if it is serious about maximising the efficiency, capacity and impact of the sector, then it must

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238 From 1 April 2005.

239 This has recently been further compounded in the case of cultural charities by the Cultural Services VAT Exemption (HM Customs & Excise Notice 701/47 - implementing the EU Cultural Services VAT Exemption). By this, cultural charities such as museums, zoos and theatres that previously charged gate tickets inclusive of VAT that enabled them to register for VAT, are now mostly exempt from VAT. They may therefore now be unable to recover the VAT they pay on the goods and services they purchase.

240 Or to primary purpose trades that were themselves an exempt supply – e.g. school fees (see Chapter 2 above).

241 Consideration would need to be given about the extent to which the *"reimbursement"* of irrecoverable VAT paid by charities might comprise State Aid under Articles 87-89 of the Treaty of Rome. This would probably appear only to be the case if the benefiting charity was in competition with commercial organisations and the charity's activities were *"tradable"* between Member States. This seems unlikely in the circumstances. In any event, there is a series of *de minimis* provisions and exemptions that could be utilised. While the issue of State Aid would need to be fully addressed before a *"reimbursement"* scheme was implemented, it appears that any difficulties could most probably be circumvented.

consider ways in which to minimise the impact of irrecoverable VAT on the sector as a matter of urgency[242].

Unfortunately, Government demonstrates no desire to do so. In its March 1999 Review of Charity Taxation Consultation Document, the Treasury stated that:

> "We have looked closely at the case for a UK grant scheme from public expenditure to compensate charities for the VAT they incur on goods and services used in their exempt and non-business activities. Having given this very careful consideration we have concluded, for reasons of principle and of cost, that this is not an idea we wish to pursue. …Any such scheme would mean a large rise in public spending on charities"[243].

This position was re-adopted in the 2002 Treasury Cross-Cutting Review on the Role of the Voluntary and Community Sector in Service Delivery, which stated that:

> "Having considered the options available, including a targeted compensation fund, the Government has concluded that no fundamental changes should be made to the way in which the VAT system operates and that the available resources would be better deployed through the new investment fund, futurebuilders, than otherwise"[244].

The futurebuilders fund is discussed in detail in Chapter 7 below. For these purposes, suffice to say that it is a one-off fund to the sector of £215 million. It is, moreover, a "capital and loan investment fund", so that generally-speaking grants must be repaid in time. It is also specifically targeted at "public service delivery through long-term investment in the voluntary and community sector in England" rather than the charitable sector specifically. How can it possibly begin to be a credible solution to the annual £460 million plus problem of irrecoverable VAT?

Even Government concedes there is a problem. For instance, in the Minutes of the Third Meeting to Review the Compact[245] between Ministers and Representatives from the Voluntary and Community Sector held on 29 April 2002, Paul Boateng is reported as accepting that there was "a long way to go" on the issue of irrecoverable VAT and that "Government would have to work with the sector to address this issue". It should do so.

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[242] This paper accepts that the issue of irrecoverable VAT could not be dealt with in the Charities Bill, but would need to be dealt with in a finance bill. Government could, however, have announced its intention to address this issue in due course as part of a package of measures around the Charities Bill.

[243] At paragraph 5.8, page 22.

[244] At paragraph 6.14, page 27.

[245] The Compact is discussed further below.

CHAPTER 7

PUBLIC SERVICE DELIVERY

One of the reasons why Government seeks to increase the capacity, efficiency and effectiveness of charities is because it wishes to enhance the role of the charity sector in the delivery of public services. Government's 2004 Spending Review states[246] that "the voluntary and community sector (VCS) has an important role to play in the drive to improve services.

Public service delivery has increased considerably over the past few years, and this is reflected in the shifting balance of statutory/voluntary funding in the sector towards statutory funding. For instance, NCVO's 2004 Voluntary Sector Almanac shows that in 2001/02 the sector's income from statutory funding had increased to 37% from 30% in the previous year[247]. The value of public services delivered by the voluntary and community sector has grown from £3.2 billion in 1991-92 to £7.5 billion in 2001-02[248].

One national charity might be a typical example. In its annual accounts for 2003-04 published in November 2004, the figures suggest that income from central and local government and other agency grants grew by 27% to £8.5 million.

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246 At paragraph 3.34.

247 Quoted in NCVO research paper by Helen Bush: Summary and policy analysis of public service delivery (November 2004).

248 As a rough guide, this amounts to about 1.5% of predicted Total Managed Public Expenditure for 2004-05: Source: Spending Review 2004, paragraph 1.10.

To its credit, Government has done a considerable amount of work in this area[249], most prominently in respect of its Compact with the voluntary sector. Furthermore, senior Government Ministers, including the Prime Minister, have re-enforced Government's commitment to engaging with the sector for the delivery of public services.

In its Report on "The Reform of Public Services: The Role of the Voluntary Sector" published in June 2005, NCVO states[250] that:

> "The Prime Minister has made clear that he wants to see public services that are framed around national minimum standards; that are accountable; that where-ever possible are devolved to the front line, allowing for local creativity and reflecting local needs; and which respect and meet the needs of diverse communities. In an often quoted statement in October 2001, the Prime Minister said:
>
> > "In developing greater choice of provider, the private and voluntary sectors can play a role. Contrary to myth no-one has ever suggested they are the answer. Or that they should replace public services. But where they can improve public services, nothing should stand in their way".

The Compact

The Compact was issued in November 1998[251]. It comprises a statement about the objectives and undertakings of Government and the voluntary and community sector to work in partnership to achieve common goals. Amongst other things, it argues that:

- voluntary action is an essential component of democratic society
- an independent and diverse voluntary sector is fundamental to the well-being of society
- in the development and delivery of public policy and services, Government and the voluntary sector have distinct but complimentary roles.

The Compact therefore suggests that there is added value for Government and the voluntary sector working in partnership towards common aims and objectives, and recognition that meaningful consultation by Government with the voluntary sector builds relationships, improves policy development and enhances the design and delivery of services and programmes.

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[249] Much other important work has been done in this field by sector umbrella bodies, most notably NCVO and acevo.

[250] At paragraph 1.3.

[251] Many aspects of the discussion in this Chapter apply to the broader voluntary and community sector (VCS). Since this paper relates to the Charities Bill, however, this Chapter focuses on the issue of public service delivery as it relates to charities.

The Compact was initially intended to apply only to central Government departments, and not to local authorities. Latterly, a series of Local Compacts have been entered into so that Government now estimates that about 89% of all areas are either covered by a Local Compact or are in the active process of developing one[252].

A number of Codes of Good Practice have now been or are being concluded pursuant to the Compact, including Codes on:

- Funding[253]
- Consultation and Policy Appraisal
- Black and Minority Ethnic Voluntary and Community Organisations
- Community Groups
- Code Champions
- Volunteering.

The Treasury Cross-Cutting Review

In Autumn 2002 the Treasury issued its Cross-Cutting Review about the Role of the Voluntary and Community Sector in Service Delivery. The Review is an endorsement of the Compact, and sets out a detailed implementation plan about how best to deliver it. According to Paul Boateng, the lead minister for the Review, the Review "provides a template for how government and the sector should work together – we need to implement the Compact, get the funding relationship right and build capacity in the sector".

The Review concludes that the voluntary sector may be able to:

- deliver services more effectively to certain groups because their particular structures enable them to operate in environments which the State or its agents have found difficult or impossible
- demonstrate more easily a range of specialised skills and experience needed to deliver services
- work together with Government to build the capacity for the sector to take on more of this work.

According to the Review, the key to the success of the Compact will be to design and deliver services that play to the sector's strengths, and about

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[252] Fifth Annual Review of the Compact on Relations between Government and the Voluntary and Community Sector.

[253] A new Code of Good Practice in Funding and Procurement was published in March 2005.

developing the skills, knowledge and resources of the sector to engage with Government should it choose to do so.

Government has set itself a Public Service Agreement Target since 2001 of "increasing voluntary and community activity, including increasing community participation, by 5% by 2006". Government asserts that this activity has already increased by 6%, which is commendable; but it is arguable that this target was perhaps unduly cautious, and that a more aggressive target should be adopted.

Government has also instigated a one-off £215 million fund[254] called "futurebuilders" which aims to improve public service delivery through long-term investment in the voluntary and community sector in England. Although of course any investment in the sector by Government is welcome, there are some structural difficulties with futurebuilders that mean that it may not be an effective way successfully to address the concerns which it sets out to remedy. It may also divert attention away from the best means to address those concerns. Futurebuilders is discussed more below.

Rationale behind public service delivery by charities

Charities that focus on service delivery in one particular field are on the whole more likely to deliver those services more efficiently and cost-effectively to a Government department or a local authority than the department or local authority itself. For instance, as can be seen from Government's assertions in the 2004 Spending Review, a 2.5% efficiency in public procurement has been targeted[255], some of which will be achieved by the use of voluntary sector organisations in public service delivery.

There is some debate in the Cross-Cutting Review about the extent to which there is added value in the delivery of public services by the voluntary sector. Government has come to acknowledge, however, that there are a number of clear elements of "added value", as follows[256]:

- connection with the community
- flexibility and capacity to take risks
- robust campaigning ability
- robust independence unrivalled by local Government

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[254] This was originally a fund of £125 million, but it has recently been increased by the Home Office.

[255] This chimes with the Gershon Review: "Releasing Resources from the Frontline: Independent Review of Public Sector Efficiency" (July, 2004), which supports the ability to achieve a £20 billion efficiency gain across the public sector in 2007-08.

[256] Comments by Rt Hon Paul Boateng MP, Chief Secretary to the Treasury, NCVO Conference on Public Service Delivery, 15 November 2004.

- trust by the community that central and local Government cannot match.

This is supported by the 2004 Spending Review[257] which identifies the following drivers to support delivery of public services by the voluntary sector:

- providing services tailored to personal needs
- exhibiting a service ethos
- delivering dividends in terms of service quality and community cohesion
- enhancing contestability through both additional capacity and contestability at the tendering phase.

In its June 2005 Report on "The Reform of Public Services: The Role of the Voluntary Sector", NCVO suggests[258] that there is a yet broader role for the sector:

> "The role of VCOs [Voluntary and Community Organisations] in the public service reform agenda is about more than delivery. VCO's play a crucial role in advocacy, campaigning, advice and information. This enables VCO's to contribute to the broad strategy for the development of particular services, and to provide a voice as well as choice. As much emphasis needs to be given to the sector's role in providing communities and individuals with a voice about the public services they want as is currently given to the issue of choice…".

There are, of course, those who suggest that it is not the role of the charitable sector to deliver public services. Their arguments can be countered as follows:

- if a charity chooses and is able of its own free will to deliver public services within the constraints of its charitable objects and more efficiently and outcome- and cost- effectively than a public body, then why should that charity not deliver those services since it will be delivering enhanced services to its beneficiaries?
- no charity is compelled to deliver public services
- appropriate and fair remuneration schemes could be put in place
- appropriate safeguards could be put in place to ensure the voluntary sector is not being exploited by the public sector

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[257] At paragraph 3.35.

[258] In the Summary.

- the "value addeds" discussed above may in themselves comprise sufficient justification to using the voluntary sector in public service delivery.

The four key blockages identified by the Treasury

The Review identified a number of concerns that block the effective delivery of public services as follows[259]:

Full Cost Recovery – The Compact places emphasis on funding a proportion of core costs and overhead as well as project costs[260].

Despite this welcome breakthrough, Government accepts that the issue of full cost recovery remains a key blockage to public service delivery. This is despite the Treasury Guidance to Funders[261] and despite some important research on the subject[262].

Government must address the full cost recovery issue and educate local authorities and Government departments about it as a matter of urgency. The Commission must also clarify its thinking on this subject.

Streamlining access and performance management requirements for multiple, and often very small, funding streams – This issue concerns, for instance, aspects such as contract tendering and the assessing and adoption of key performance targets. There is a general sense that tendering processes are still inconsistent, so that an element of unfairness creeps in[263]. Equally, in relation to key performance targets there is a sense of frustration on both sides: from charities because they feel that – often unrealistic - KPTs are imposed upon them by contracting authorities; and from the public sector because they feel that the charities have not put in the time and effort to formulate their own achievable KPTs. Clearly more work must be done here; and this issue is dealt with more below.

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[259] There are differing views about what might comprise the key blockages in voluntary sector public service delivery. For instance, the acevo Commission of Enquiry Report on Surer Funding (acevo, November 2004, at page 19) states that the most significant blockages are: variable standards in governance; leadership and capacity deficits; and inadequate funding and contracting requirements.

[260] There is an emerging view that "full cost recovery" is a more useful description of this issue than "recovery of core costs" (see, for instance, NCVO's paper "Understanding Futurebuilders England", November 2004). Core cost recovery, however, must be an element of full cost recovery, so the concept of "core costs" – as an appropriate apportionment to a project of indirect costs and overhead - is maintained for the purposes of this paper.

[261] Guidance to Funders – Improving Funding Relationships for Voluntary and Community Organisations: A response to Recommendations 19 and 21 of the Cross Cutting Review, HM Treasury, September 2003.

[262] See, for instance, "Full Cost Recovery: A guide and toolkit on cost allocation" by Caroline Fiennes, Cathy Langerman and Jeni Vlahovic, Published by New Philanthropy Capital and acevo.

[263] NCVO research paper by Helen Bush (November 2004): Summary and policy analysis of public service delivery.

End loading of payments – Government recognises that payment in arrears often results in the sector bearing the up-front costs of applying voluntary income to performing public service delivery contracts and borrowing, and the risks that this entails. Government acknowledges that more can be done to encourage advance payments. In particular, Paul Boateng has accepted[264] that often public bodies hide behind Treasury funding rules when negotiating, but the rules are more flexible than some think. For instance, it is not true in many instances that advance payments are not possible. The suggestion was that charities seeking to contract for public service delivery should familiarise themselves with the Treasury Rules for negotiation purposes, in particular the Treasury Guidance for Funders[265] and the Home Office publication Think Smart, Think Voluntary Sector[266] which deals with public sector procurement issues. These issues are dealt with in more detail below.

In this regard, and in the discussion about protecting charities in the contractual context below, there is a general sense that the sector needs to "pull its socks up" in negotiations and play tougher to obtain a fair deal, particularly on cost recovery. Despite the problems discussed in this Chapter, it seems clear that Government is prepared to engage with the sector in a forthright and open way in an attempt to remove the blockages to public service delivery to the benefit of all concerned - sector, public body and beneficiary.

So, in the foreword to Guidance to Funders, Paul Boateng wrote:

> "We are guided by government accounting to make sure public funds are spent in a way that generates the best possible outcomes for taxpayers. This should not be seen as an obstacle to putting in place funding arrangements that facilitate spending for agreed purposes in order to make partnerships work in delivering our shared objectives. Dispelling myths about what the "rules" do and do not allow is vital if funders and voluntary and community organisations are to enter into more sensible funding relationships. Removing existing confusion and misunderstanding will result in funding relationships that are both empowering and enabling".

Clearly this discussion brings into relief that, regardless of statutory recommendations and the ability to regulate contracts and other relevant areas, for public service delivery to work in practice there must be a paradigm shift in the culture of both the public and charitable sectors. Aside, therefore, from debates about what should or should not be included in the Bill, both sectors need to work hard at this. Given that this will take time and money on the part of the charitable sector, and given Government's assertions that public service delivery by the voluntary sector comprises an important tool in

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[264] Comments at NCVO Conference on Public Sector Delivery, 15 November 2004.

[265] See above.

[266] Think Smart… Think Voluntary Sector – Good Practice Guidance on Procurement of Services from the Voluntary and Community Sector, Office of Government Commerce/Home Office, June 2004.

achieving 2.5% cost efficiencies[267], Government should formulate proposals to fund an educational programme within both the charitable sector and central and local Government to enable this to occur. Part of the message must surely be that it is appropriate in the context of the discharge of their statutory duties for both central and local Government to take a short term risk in engaging a charity to deliver public services in return for the long term savings of both cost-efficiencies and other "added value".

Stability in the funding relationship - This focuses primarily on work around extending public service delivery contracts from short-term to long-term. This is addressed in more detail below in a more general discussion about contractual arrangements and culture.

Subsequent recommendations in the 2004 Spending Review

In the light of the 2004 Gershon Review[268], Government has identified a further series of cross-cutting efficiency measures, that might be relevant to the delivery by the voluntary sector of public services, as follows[269]:

- improving the approach to procurement across departments
- reinforcing processes to achieve higher rates of take-up of re-enabled transactional services[270]
- a review of the efficiency and effectiveness of key delivery chains
- simplification of the funding and regulation of services delivered by the voluntary and community sector, and reinforcement of the principle of full cost recovery.

Government should ensure that it deals with these issues as a matter of urgency. Some of the arguments around these issues are discussed below.

Other key concerns

The Compact has not yet resolved the key blockages towards effective public service delivery by charities. One of the most disappointing aspects of the Bill is that the opportunity to tackle these issues has not been taken through an express package of measures around it.

Some key concerns include:

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267 See 2004 Spending Review, above.

268 Sir Peter Gershon CBE "Releasing Resources to the Front Line, Independent Review of Public Sector Efficiency", July 2004.

269 2004 Spending Review, paragraph 2.23.

270 This might be achieved, for instance, by outsourcing transactional activities to voluntary sector organisations.

Futurebuilders

Futurebuilders is a one-off £215 million[271] fund which aims to improve public service delivery through long-term investment in the voluntary and community sector in England. Futurebuilders aims to invest in the five public service delivery areas of community cohesion, crime, education and learning, health and social care and support for children and young people. The fund aims to invest in around 250 organisations with investments ranging from approximately £30,000 to £10 million. While investment packages will primarily comprise of loans, they may also include development and capacity-building grants.

Futurebuilders is intended to be a flexible scheme. As part of its mission it has a self-developmental aim:

> "Futurebuilders is also a learning exercise. It aims to understand and communicate the possibilities for voluntary and community sector public service delivery, and the best in local procurement practice. We also want to understand and disseminate ways of sustaining voluntary action beyond resilience on time-limited grants. Futurebuilders itself aims to learn from its own mistakes to ensure continual improvement in the investments it makes"[272].

Futurebuilders also aspires through its loan scheme[273] to "recycle" the Futurebuilders fund amongst as many voluntary sector organisations as possible, thus maximising its effect:

> "the aim is that by using a range of finance options Futurebuilders will make its funds go further than other providers and that this new type of finance will help develop an investment culture in the sector with less dependency on short-term grants"[274].

The key objection to futurebuilders is probably that it is primarily a "capital and loan investment fund", so that generally grants must be paid back over time. This proposition makes futurebuilders relatively inaccessible. In any event, is £215 million sufficient to tap the public service delivery potential of the sector? Certainly it is a drop in the ocean compared to other areas where Government could assist the sector financially, for instance in relation to irrecoverable VAT. One informed charity caseworker has suggested that the general impression

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[271] The original futurebuilders fund was £125 million, but this has recently been increased by the Home Office by £90 million.

[272] From NCVO's publication "Understanding Futurebuilders England – A guide to the aims, context and process of the Futurebuilders fund", November 2004 (at page 5).

[273] According to futurebuilders loan periods will be for periods of between twelve months and twenty six years. Interest should be assumed to be at 6%. Loans will usually cover either capital asset costs or working capital.

[274] From "Understanding Futurebuilders England", as above (at page 5).

was that futurebuilders was "beyond the scope and reach of most of the sector"[275].

Given the issues around full cost recovery discussed both above and below, the fact that a charity may not be able to allocate a reasonable proportion of the repayment of its futurebuilders loan to a public service delivery project costs will be a considerable disincentive. Depending on the terms of grant of a futurebuilders loan then there may be no direct financial return from the loan with which to pay it off. This may be a particular barrier to smaller organisations that are keen to engage in public sector service delivery.

Clarity about the legal basis behind cost recovery

The Commission's guidance (CC37, paragraphs 21 to 32) issued in September 2003 suggests that "Trustees cannot normally use a charity's funds to pay for services that a public body is legally required to provide at the public expense. However, trustees may use a charity's resources to supplement what the public body provides".

This has the potential to send a mixed message to the sector – on the one hand Government is encouraging the sector to participate in the delivery of public services; on the other the Commission is advising that charities cannot use their own funds to deliver services that a public body is legally required to provide at the public expense, but merely to *supplement* those services. Of course, the question about what "supplement" precisely means in these circumstances is open to debate.

The provisions of CC37 appear to conflict, at least to some extent, with Commission publication RR7[276] which states[277]:

> "…Nor is it a bar to charitable status that the body has been created with a view to taking on a government function. What is important is that the purposes for which this the new body exists should be exclusively charitable. The mere fact that the body will help a governmental body to carry out one of its functions does not undermine the body's claim to charitable status… There is therefore no difficulty, in principle, in local authorities establishing charities for the purpose of providing leisure facilities for the public, for example, or providing housing for the poor, and hiving off existing facilities to those charities… However, for a body to be a charity, it must be independent. By this we mean that it must exist in order to carry out its charitable purposes, and not for the purpose of implementing the policies of a governmental authority, or of carrying out the directions of a governmental authority".

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[275] The first futurebuilders applications round for funding closed on 31 October 2004. The second round will commence on 1 June 2005. The fund envisages a three year funding programme.

[276] February 2001.

[277] At paragraphs 3, 4 and 5.

This confused position appears to have been superseded by a decision of the Commissioners[278] that was made on 21 April 2004, but which was only publicised by the Commission on 21 February 2005[279]. This decision concerned applications for registration of Trafford Community Leisure Trust and Wigan Leisure and Culture Trust, both of which contemplated the delivery of public services on behalf of local authorities that the local authorities were by statute obliged to provide and had (or were about to) enter into service delivery contracts in that regard. The Commissioners determined that these cases raised two key issues: first, whether the Trusts were sufficiently independent from the respective local authorities; and secondly, the extent to which the Trusts could be charities if they were established to carry out statutory duties imposed on governmental authorities[280].

The first issue will be discussed in more detail in this Chapter below. In respect of the second issue, however, the Commissioners determined[281], contrary to the principles set out in CC37, that:

- provided that new bodies were established as independent organisations with exclusively charitable purposes operating for the public benefit, there was no rule of law that prohibited them from being charities, even though they operated to discharge a function or service that a Governmental authority had a responsibility to provide[282]

- the extent to which trustees could properly apply charitable funds to further their objects towards discharging a statutory duty so as to relieve the local authority was a question of the proper discharge of trustees' duties

- there was no law prohibiting trustees from entering into a contract with a Governmental authority to carry out a function or service of that authority, whether or not the authority was under a statutory duty to provide the function or service

- guiding principles for trustees in determining whether to enter into such a contract were whether:

  - the function or service fell within the objects and powers of the charity

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278 Charity Commission Decisions of the Charity Commissioners for England and Wales made on 21 April 2004: Applications for Registration of (i) Trafford Community Leisure Trust; and (ii) Wigan Leisure and Cultural Trust.

279 This is a key example about one of the concerns of the transparency of the Commission (and of the future Charity Appeal Tribunal) addressed in Chapter 4 above.

280 See paragraph 4.

281 At paragraph 6.

282 It was noted in this context that it was accepted as a good charitable purpose to relieve the community from general or local taxation, provided that that purpose was applied for the benefit of a sufficient section of the community. See, for instance, AG v Bushby (1857) 24 Beav. 299.

- undertaking the function or service was an effective way for the charity to meet the needs of its beneficiaries

- the trustees were able to secure, in the best interests of the charity, proper consideration from the Governmental authority, in terms of funding and resources for the function or service.

This again raises the question of full cost recovery.

In CC37 the Commission makes clear that in this context trustees "must expect the public body to meet the full costs of providing a service which that body is legally required to provide". It could be argued, however, that this would be highly unlikely ever to happen, because even if the public body contributes towards core costs (as is now recommended), there may also be other allocatable costs, such as unquantifiable indirect costs and costs in lost opportunities to expand the charity's free income and resources from other sources while management and other resources are diverted to fulfil the contract[283]. There are also reputational risks to consider.

Further, on a strict legal analysis, once a public body pays a charity under a contract, that payment comprises the charity's "own funds", so, on a literal interpretation of the Commission's advice in CC37, funds received could not be used to discharge the contract[284].

This position appears to have been superseded by the Trafford and Wigan decisions, since the Commissioners go on to consider in what circumstances trustees might enter into a contract with a Governmental authority that did not provide full consideration for the service to be delivered. They determined[285] that the factors to be considered by trustees included the extent to which trustees might: first, use charitable funds either to subsidise that service or to provide an enhanced service; and, secondly, provide a service that a Governmental authority was under either a statutory duty or a discretionary power to provide without any consideration from that Governmental authority.

The Commission concluded[286] that trustees could act in this way because these matters clearly fell within their discretion, provided that at all times they acted within the objects and powers of the charity, had due regard to the proper exercise of their powers and acted in the charity's best interests. The key issue was whether the expenditure on the service proposed was justified as a proper and effective use of the charity's resources in meeting the needs of its beneficiaries.

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283 See above in relation to research being conducted on this subject.

284 This is, of course, highly unlikely to be what the Commission means.

285 At paragraph 6.1.8.

286 At paragraph 6.1.9.

Within these considerations, factors that the Commissioners felt to be important to be taken into account were[287]:

- the need to negotiate to secure a proper level of funding and resources for the level and standard of service to be delivered

- where trustees contract to deliver services that a Governmental authority is legally required to provide with no discretion over the level of provision, they should generally expect the Governmental authority to meet the full cost

- the need to have regard to (a) the social and economic need for the service and its enhancement over and above that which the Governmental authority would support; (b) the best interests of the charity's beneficiaries

- the need to consider why the Governmental authority is not carrying out its responsibilities, particularly if it has no discretion over the level of provision, and whether, in that context, and in the wider context of the wider social and economic need for the service, the delivery of the service by the charity is the most effective use of its resources and in the best interests of its beneficiaries.

It is regrettable that the Trafford and Wigan decisions have not yet been reflected in CC37, since trustees will be confused about the correct legal position. The Commission's decision in Trafford and Wigan is to be welcomed, however.

Superficially, the Trafford and Wigan decisions appear to undermine the sector's legal arguments in favour of the need for full cost recovery. This need not necessarily be the case, however, since the decisions require the trustees to have regard to the most effective use of the charity's resources and the best interests of its beneficiaries. There must in that context be a strong argument that it will often not be in the best interests of a charity's beneficiaries to deliver services to a required standard for a Governmental authority that is itself statutorily obliged to deliver those services to the same standard unless the charity recovers its full costs, including an appropriate proportion of core costs. For if the charity did not contract to deliver those services it would be supplied anyway by the Governmental authority, so that the charity could focus on meeting other needs within the community and broadening its beneficiary class.

This conclusion, however, again highlights the uncomfortable position that full cost recovery is presently honoured more in the breach than in the observance. As a result, many public bodies may be imposing contracts that force charities to delve indirectly into their voluntary-funding coffers; and, if so,

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[287] At paragraph 6.1.10.

placing many trustees of charities delivering public services in technical breach of trust.

This merely re-enforces the arguments discussed above that Government must urgently address the full cost recovery issue so that trustees feel confident about entering into public service delivery contracts and are not deterred.

Capacity-building

Capacity-building is generally understood to be "the development of an organisation's core skills and capabilities, such as leadership, management, finance and fundraising, programs and evaluation, in order to build an organisation's effectiveness and sustainability. It is the process of assisting an individual or group to identify and address issues and gain the insights, knowledge and experience needed to solve problems and implement change"[288].

The funding of core costs, overhead and project costs alone does not help a charity to expand its organisational capacity beyond the relevant project. Thought should be given to the possibility of an additional "capacity fee", that might be calculated as a capped proportion of project costs, to help the charity build capacity independently of the relevant project.

There is a sense within the sector that capacity building should be dealt with through grants rather than through "capacity fees" in contracts[289]. With respect, however, there is a number of potential problems with this grant model:

- there is a risk of a "disjoining" between a grant to build capacity against a contract to deliver public services. It will not always be the case that a local authority, say, having awarded a remunerative service delivery contract to a charity, will then be amenable to making a capacity building grant to the same organisation. The risk will be that, if capacity-building is left to grants rather than to contract fees, capacity building will always be subordinate to contract delivery

- even if grants and contracts are linked, this creates the risk that charities might enter into more onerous contracts than they might otherwise do, so as to be assured of a capacity grant. Equally, contracting authorities might be reluctant to make a refundable

[288] From "Reflections on Capacity Building", The California Wellness Foundation, 2001. This report goes on to state that capacity-building may be facilitated through technical support activities such as coaching, training, specific technical assistance and resource networking. Other research on capacity-building includes research by McKinsey & Co in conjunction with Venture Philanthropy Partners: "Effective Capacity Building in Nonprofit Organisations", August 2001.

[289] See, for instance, comments made by Ed Mayo (National Consumer Council) and Stuart Etherington (Chief Executive, NCVO) at the NCVO Conference on Public Service Delivery, 15 November 2004.

capacity grant when they know or suspect that a proportion of the costs of repaying it might be charged back as part of full cost recovery.

- if grants and contract fees derive from different sources, there will always be the risk that the grant maker and the contracting public body might issue mutually inconsistent terms; and that the grant awarded does not match the capacity-building needs for the relevant contract.

Ways must be found to avoid these difficulties if grants are to be the best way forward for capacity-building.

Government has accepted[290] that the efficiency gains to be obtained from the retention by public bodies of charities to deliver public services should not be an excuse for cutting back the sector, but to expand its capacity and to be applied to the front line. This argues for considerable sums to be allocated – perhaps by way of capacity building grants – towards capacity building in charities that deliver public services. Government should commence work on proposals about how to achieve this as soon as possible.

More thought should be given as to how charities delivering large public authority contracts might contribute to Government's "capacity building" aspirations.

Infrastructure

Related to the capacity-building debate is Government's "ChangeUp" initiative[291], which aims to increase the infrastructure and capacity of the voluntary sector. The initiative derives from some of the recommendations in the Treasury Cost-Cutting Review that the voluntary and community sector and central and local Government should develop a shared strategy to underpin the sector's capacity.

The High Level Aim of the initiative is to procure that:

> "By 2014 the needs of frontline voluntary and community organisations will be met by support which is available nationwide, structured for maximum efficiency, offering excellent provision which is accessible to all while reflecting and promoting diversity and is sustainably funded".

The Home Office has committed to invest about £93 million in ChangeUp between 2004 and 2006[292]. It does, however, contemplate that the sector

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290 Comments made by Paul Boateng while he was Chief Secretary to the Treasury at the NCVO Conference on Public Service Delivery, 15 November 2004.

291 Published in the Home Office ChangeUp Report, June 2004.

292 But compare against the annual £460 million problem of irrecoverable VAT for charities (see Chapter 5 above).

must source other funding for the initiative to work. In the Foreword to the ChangeUp Report, the Charities Minister stated that:

> "Sustainability can only be generated if other funders ensure that their involvement takes account of the capacity needs of frontline organisations and fund the infrastructure that supports them. The costs of infrastructure support should also be included in contracts and grant payments to frontline organisations".

To the extent that this comprises a plea to the public sector to include infrastructure costs as a part of full cost recovery, there are currently serious blockages which suggest that this objective may not be easily achievable. They must be addressed urgently.

Some of the key objectives of the ChangeUp Report are that:

- the necessary capacity would be met in a variety of ways: by organisations helping each other, through pro bono work, from public sector and other funders of frontline organisations and organisations' own regional and national structures

- a higher proportion of infrastructure costs should be funded by frontline organisations through membership fees and sale of services. The costs of infrastructure services should therefore be included in the core costs of delivery[293]

- the public sector has a key role to play in maintaining the existence of strong and robust infrastructure. Public sector funding should be long-term, strategic and focussed on clear objectives which infrastructure bodies should deliver to agreed standards

- ChangeUp aims to achieve further High Level Objectives by 2014 across eight National Hubs of Expertise[294].

ChangeUp is a very welcome initiative that commendably dares to take a ten year view. For this Government must be applauded. As the Home Office itself admits, however, ChangeUp depends upon a number of external factors for its success, many of which are identified as core blockages both above and below within this Chapter. For the initiative to work, these blockages must be addressed as a matter of urgency.

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[293] There may be a tension between the membership fees and price to beneficiaries for services that a public body might be able to accept and, in the case of a charity, that might be regarded as acceptable by the Charity Commission in the context of the "wider access" debate. See, for instance, the concordat between the Commission and the Home Office and Chapter 3 above.

[294] These Hubs are: Performance Improvement; Developing a Highly Effective Workforce; ICT; Governance; Recruiting and Developing Volunteers; Financing Voluntary and Community Sector Activity; Infrastructure; and Reflecting and Promoting Diversity.

Awareness

Awareness of the Compact must be raised yet further in both the voluntary sector and within Government departments and local authorities. In the Fifth Annual Review of the Compact on Relations between Government and the Voluntary and Community Sector a survey concluded that only 57% of 289 respondents well understood the main Compact document. Even more disappointing, in 2002 only 60% of local authorities were Compact-active, while almost half the responding local groups were not sure about the stage that their Local Compact had reached. Although, as mentioned above, Government now estimates that about 89% of all areas are either covered by a Local Compact or in the active process of developing one, more work needs to be done to ensure that Local Compacts are actually and properly implemented and applied, and that the local voluntary sector stakeholders are made aware about their existence and effect[295].

Further, Paul Boateng MP, then Chief Secretary to the Treasury, said[296] that many local authorities merely pay lip-service to the Compact concept, while others ignore it completely. As a result, one of the great challenges is to extend the spirit of the Compact to local authorities.

Duration and terms of contracts

It will often be the case that local authorities will want to retain charities to deliver services on short term contracts. If the whole of a charity's resource will be devoted to delivering that contract, then the charity will be in a poor negotiating position at the end of the contract, and will have no security of tenure for a reasonable duration. The result will be staff insecurity and a lack of clear forward thinking.

A survey of 100 charities involved in public service delivery has shown[297] that 92% had contracts for public service delivery lasting one year or less, and 86% say that this is hampering service delivery. In particular, strategic planning, staff recruitment and retention and investment in training and ICT were all adversely affected.

Equally, charities may find that, in the proper discharge of public service delivery, they are required to criticise or take action against a contracting authority. One example of this is in the context of charities that deliver advice for local authorities to those resident in the local authority area. Often the charity will bring or defend proceedings against the local authority for a client that has been referred to them by the authority as part of their service delivery

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[295] There is a potential distinction between having a Local Compact and being "Compact-active", which may account for the 60%-89% discrepancy here as well as time effluxion and developing circumstances.

[296] NCVO Conference on Public Service Delivery, 15th November 2004.

[297] Quoted from The Guardian, 21 April 2004, interview with Stephen Bubb, Chief Executive of acevo. The whole issue of contract duration is being looked at in detail by acevo and New Philanthropy Capital in the "Surer Funding" initiative. A report was published on 30 November 2004 (see below).

contract. Clearly, ways must be found to safeguard the charity's position against any adverse pressure from the authority in these circumstances.

Ways to mitigate this problem might include a Code of Conduct on Contracts that, as a minimum,:

- encourages and rewards long term contracts
- makes clear that criticism of, taking action against or defending an action by a local authority by a charity it has retained cannot amount to a breach of contract if such criticism or action comprises a bona fide discharge of the charity's delivery of services
- prohibits conditions that preclude the charity from having other clients for the duration of the contract
- acknowledges that charities have a right to service more than one public service delivery contract at a time and also engage in non-statutory charitable activities
- respects the voluntary funding/statutory funding ratio adopted by the charity
- requires local authorities to negotiate fairly and proportionately with the charity during contract renewal
- requires local authorities that have representatives on charity boards to comply with the Charity Commission's guidance on management of conflicts of interests in those circumstances[298]
- requires the adoption of proportionate and mutual termination provisions with adequate notice periods taking into account the proportion of overall operations which the charity is devoting to the contract
- requires confidentiality and administrative provisions (including compliance costs) that address the relevant aspects of the Freedom of Information Act 2000[299]
- recognises that, if the public sector seeks the "added value" of risk and innovation from its charitable sector partners, the contract must give the charity sufficient leeway, for instance, in terms of delivery parameters, key performance targets and termination provisions, to accommodate that

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[298] See further below on managing conflicts of interest.

[299] See below for a more detailed discussion about the impact of the Freedom of Information Act 2000 on public service delivery by charities.

- permits fair liquidated damages clauses in favour of the contracting charity should the contract be arbitrarily terminated early by the relevant public body.

Contract culture

There must be enhanced awareness that both the Compact and the Local Compacts are merely frameworks for engagement between national and local Government and the sector, rather than the means of engagement itself. In that respect, the devil will always be in the contractual detail, and more needs to be done to educate Government departments and local authorities about fair contract terms in that engagement (see below). The Commission publishes guidance (CC37) about Charities and Contracts, and about the Independence of Charities from the State (RR7) but its adherence to these could be easily compromised by a local authority with bargaining power, and the relevant department or authority is not obliged to abide by them.

Public service delivery and risk

As part of this culture change, public bodies must recognise that they cannot burden all of a project's risk onto the contracting charity.

One of Government's stated attractions towards voluntary sector public service delivery is the sector's ability to innovate and take risks in ways in which the public sector cannot hope to do. Government must accept, however, that purchasing innovation and risk comes with a cost. If public bodies continually require contracting charities to take risks without an appropriate resulting reward, then contracts will be one-sided, charities will become de-motivated, trustees will be in fear of breaching their trust, and the virtuous circle which Government seeks to invigorate will collapse[300].

Government must take steps to ensure that the contract culture within public bodies shifts to allow them to themselves take the risk of reaching an appropriate balance of risk and reward in their public service delivery contracts. All risk and too little reward will be the eventual death knell of the Compact initiative.

More therefore needs to be done in this area. Acevo and New Philanthropy Capital published a "Surer Funding" report on 30 November 2004[301] dealing with precisely this topic. It would be inappropriate to consider the report in detail in this paper, but key amongst its recommendations is a

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[300] A considerable amount of research is currently being done to evaluate the costs to the sector of these problems with contract culture. For instance, the acevo Surer Funding Report (Surer Funding: acevo Commission of Inquiry Report (research by New Philanthropy Capital), published by acevo, November 2004, at Appendix 3) identifies a number of costs around contract culture and risk, such as: adverse human resource consequences; the need for higher reserves; adverse implications on the ability to access capital; and adverse implications on the ability to plan for the future.

[301] Surer Funding: acevo Commission of Inquiry Report (research by New Philanthropy Capital), published by acevo, November 2004.

recommendation that Government funders should be subject to a kite mark by an accreditation body which would be awarded against conformity with principles for better funding. These principles would be:

- sharing the responsibility for the delivery of risk
- contracting for an appropriate time scale
- cutting waste caused by bureaucracy
- fair costing and pricing.

Government would also be expected to establish a penalty scheme for contracts that fail to comply with the principles; and an independent ombudsman would be set up to identify, criticise and penalise parties for poor practice in contracting. In return, the voluntary sector would undertake further work on borrowing requirements, exploring new models of long-term structured finance for third sector consortia and learning from PFI/PPP models, and procurement practice. It would also undertake a programme of skills development in finance and contract negotiation, including working with Regional Development Agencies.

This work is to be welcomed. But it should not encourage complacency: it has not even been adopted as policy, let alone implemented: and, as the Compact experience has shown, these are quite different things.

Tendering

Government procurement rules can be bewildering to charities, and can exclude smaller charities from engaging with the public sector to bid for the provision of public services. While it is true that public bodies must comply with these rules to the extent they are mandatory, it appears that public bodies choose to use these rules as an excuse to avoid having to negotiate reasonable contracts or to address the more sophisticated issues of risk and reward and up-front payments.

In response to the recommendations of Sir Peter Gershon CBE in his Independent Review of Public Sector Efficiency[302], Government identified in the 2004 Spending Review[303] that procurement management could be improved and that every Government department had to agree four key drivers to effect that by December 2004[304]. Key amongst these for charities delivering public services are:

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[302] "Releasing resources to the Front Line", July 2004.

[303] At paragraph 2.28.

[304] This chimes with the 2004 Spending Review findings relating to procurement in relation to the delivery of public services by the voluntary sector.

- enhancement of procurement capacity by improving leadership and professional skills, together with the strong, consistent application of best practice tools and techniques

- improving the strategic management of key supply markets (e.g. the voluntary sector)

- improving value for money.

If properly applied, this could bode well for the delivery of public services by the voluntary sector; but Government should ensure that public bodies are fully appraised and trained up in the particular needs and concerns of the voluntary sector in the tendering process.

It should also be recognised that the process is also time-consuming and costly to the sector and account should be taken of this in pricing and cost recovery. It is useful, for instance to consider in this regard the findings of the 1999 Gershon Procurement Review[305] which identified that:

> "Tendering to government is burdensome and costly to suppliers. Inputs from industry indicated that bidding for government contracts is typically 10-50% more costly than bidding for comparable projects in the private sector with the key drivers of these cost burdens being the greater level of detail required and more extended time-scales".

Elsewhere in the 1999 Procurement Review[306] it is stated that "… the scale and breadth of… [procurement]… expenditure demands the highest levels of efficiency to achieve the best possible value for money". But there must be a balance, if public bodies are too risk averse in achieving this aim, the result will be more inefficiency and more lost opportunities.

This is a trend taken up further by the 1999 Procurement Review:

> "Despite the declared government procurement policy being based on value for money rather than lowest initial cost, many inputs from industry highlighted a perception that the culture of the Civil Service is risk averse and the "safe" option is justifying the lowest up front cost. While invitations to tender do usually specify the value for money criteria, it does not appear to be standard practice even to specify the relative priority and weightings of the different criteria"[307].

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[305] Gershon Review of Civil Procurement in Central Government, April 1999, at Paragraph F2. This is to be distinguished from the 2004 Gershon Review (see above). Clearly this procurement review applied only to procurement in the central Government context, but it may by analogy also be illustrative of issues arising in local Government procurement.

[306] Introduction, paragraph 4.

[307] Gershon 1999 Procurement Review, paragraph F5.

In the light of all this, the 1999 Procurement Review recommended[308] that:

> "In major purchases covered by the proposed common procurement process, I recommend that the procurement strategy takes into account the estimated total costs that will be borne by industry in bidding for the contract as well as the total costs to be borne by the Department".

Contract cost recovery should therefore include the costs of procurement. This will not, however, cover the lost tendering costs of unsuccessful bidders which, while perhaps justifiable in the private context, are more difficult to justify in the charitable one, since trustees will have to justify that it is in the best interests of the charity that it take the risk in incurring those costs in the procurement process.

Equally, thought also needs to be given to the fact that, in the tendering context, charities that seek to take the most responsible approach are unlikely to provide the cheapest solution. Indeed, if the public sector seeks the "added value" of innovation and risk-taking from their charitable sector partners, it must expect that pricing will increase to reflect that, and to reflect the fact that appropriate contingency reserves will have to be built up to provide a buffer against the crystallisation of risk.

The tendering process can be a real barrier to the delivery of public services by charities. All possible steps should be taken to minimise the effects of this barrier as soon as possible.

These issues lead to another difficulty in the context of the developing market for the provision by charities of public services to public bodies. The procurement barrier may mean that smaller charities with plenty of appropriate knowledge, skill and knowhow will be disadvantaged, and in some circumstances unable to survive. For instance, the Surer Funding Report[309] states that:

> "We are aware that, as in many market scenarios, increasing competition, in this case for public sector contracts, can go hand-in-hand with a shake-out of weaker suppliers. Those that win would be third-sector organisations with the capacity or asset-base to tender and negotiate to greater effect. The successful organisations will be those that combine the human-scale of a focus on user needs with the economies of scale of a successful enterprise".

This may not, of course, be a bad thing, especially given Government's initiative to encourage charities to merge and combine resources. But as the voluntary sector public service delivery market continues to develop and mature, there must be open debate about whether this is a desirable result in

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[308] Gershon 1999 Procurement Review, paragraph F11.

[309] See above, at page 11.

the context of the sector; and, if it is, about how we best capture and maintain the knowledge, skill and know-how of those organisations that do not survive.

Measurement

In their contracts for public service delivery by charities, public bodies will often seek to link payment against delivery measured by specified key performance targets (KPTs). Typically, the sector has been slow to devise its own KPTs and has relied upon the public bodies with which they contract to impose them. These KPTs may often be arbitrary in the context of a service delivery environment where measurement may be extremely subjective, if sensibly possible at all. The charity concerned may even have little or no control over the fulfilment of the KPT.

This is highly unsatisfactory, especially when payments are often made in arrears and withheld against the achievement of KPTs. As an example, one charity provider entered into a contract where it was only entitled to recover core costs from a local authority if it met the applicable KPTs.

If the voluntary sector public service delivery market is to achieve its full potential, then the sector and Government must work together to devise appropriate measurement schemes that are fair to all, and are based on empiricism rather than subjectivity.

Freedom of Information Act 2000 compliance

The ongoing phased introduction of the Freedom of Information Act 2000 will means that as from January 2005 charities delivering public services may have been liable in certain circumstances to provide certain information as if they were themselves the contracting authority. Public bodies caught by the Act cannot contract out of it. There may be significant direct and indirect costs and administration time devoted to this, and these should be compensated for in the pricing arrangements for any public service delivery contract. There are consequent confidentiality issues that must also be addressed. In any event, the Act will foster enhanced negotiations with charities about what comprises confidential information or what parts of a contract comprise a "commercial interest", since these provisions will enjoy qualified exemption under the Act. This will obviously mean that charities will incur further negotiation cost and management time that may not be fully recovered.

Professionalism of charity boards

It is a fundamental legal principle that charity trustees cannot usually benefit from their trust unless expressly authorised by their trust instrument[310]. This has meant that a generally voluntary trustee body has developed, and that the concept of unpaid voluntary participation is generally accepted throughout the charity sector.

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[310] See, for instance, Tudor on Charities (9th Edition, 2003, chapter 20, section 1).

This does not mean, however, that it is impossible to have paid trustees. The Charity Commission takes the view that if a charity can make a case that it is in the charity's best interests for a trustee to be paid, then the Commission will accept that argument and permit it. The trustees of some very large charities such as the Wellcome Trust are paid (sometimes in accordance with a Civil Service scale) on the basis that their activities are sufficiently complex and time-consuming that the decision to pay them is in the charity's best interests. Equally, for example, the artistic directors of a number of dance and theatre charities are paid as trustees on the basis that it is in the charity's best interests that the artistic director, a paid executive, should have a voice on the Board.

More recently, in August 2004 the Charity Commission prominently permitted St Andrew's Group of Hospitals, a not-for-profit hospital charity that provides services to the NHS, to have 50% of its board of ten as paid executives, with the other 50% being non-executive volunteers. The charity has committed to applying appropriate elements of the Combined Code on Corporate Governance, including the need for a nominations committee and a remuneration committee.

As charities become larger and more sophisticated, and as the case for charity delivery of public services improves, there is a strengthening argument that larger charities should be permitted as a matter of course to have paid executives on the Board. This is the case with listed companies – themselves publicly accountable – so why should it not be the case with the larger charities? It seems strange that the sector is now expected to expand its capacity to engage in public sector delivery due to the "added value", for instance, of enhanced risk and innovation through the governance of a wholly amateur Board. The development of innovative funding techniques – such as, for instance, bespoke debt finance – are also hampered by the perceptions of potential funders about wholly amateur charity Boards.

There has been considerable debate within the sector about this issue; and there is division about the extent to which paid trustees are appropriate[311]. Surely, however, if we are to have a dynamic, modern and sophisticated sector, the advent of the charity Board with a series of paid executives should be permitted. Advantages might include:

- an enhanced feeling of accountability and "ownership" of the charity for executives who are trustees
- an enhanced feeling by the Board as a whole that it is in full understanding of the issues affecting the charity through the ownership and responsibility of the paid executives
- Board members who are able to attend to their duties on a full-time basis and not as part-time volunteers

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[311] NCVO for instance is strongly opposed to paid trustees in most circumstances.

- an enhanced feeling of "professionalism" amongst trustees

- enhanced and appropriate regulation, for instance, by the adoption of appropriate elements of the Combined Code.

In consequence, there is a strong argument for the introduction of legislation that permits paid executive trustees for some charities, with certain safeguards. These executive trustees could be paid whether or not the charity's constitution expressly permitted it, as long as there was no express prohibition. Safeguards might include:

- the dominance of an express prohibition in the charity's constitution

- the fact that trustees will still have to determine that having paid executives on the Board is in the best interests of the charity

- an appropriate minimum income threshold[312]

- a maximum of 49% of the Board can be paid

- paid Board members could not be non-executives and would have to be paid in accordance with their executive contract with no additional uplift for being a trustee; so that, strictly speaking, their payment would not be categorised as a payment to a trustee in fulfilling a trustee duty

- a requirement that non-executive trustees must be voluntary and cannot be paid (for instance as non-executive directors of listed companies are paid)

- a requirement that the safeguards in appropriate elements of the Combined Code or analogous safeguards are entrenched (whether by statute or in the charity's constitution): for instance, safeguards relating to governance in relation to meetings when the Board member's remuneration is discussed.

One of the main objections to paying trustees is that it could undermine the ability of smaller charities to obtain good trustees, or might over-stretch them in trying to pay trustees. The safeguards listed above, however, help to neutralise this concern: if only executives can be paid on the Board, they would be being paid anyway as non-Board members; and a minimum income threshold would ensure that smaller charities are not tempted to over-stretch themselves.

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[312] Thought would need to be given to how payment of executives as trustees would be managed if a charity failed to meet the minimum income threshold in any year having achieved it in previous years.

S34 of the Bill sets out circumstances where trustees of a charity can receive remuneration for services rendered to the charity if certain safeguards are met. While this might seem to be an answer to this situation, S34(7) states that nothing in S34 applies to "any remuneration for services provided by a person in his capacity as a charity trustee or trustee for a charity or under a contract of employment". As a result, S34 will not apply to allow charities to appoint paid executives as trustees.

Government should consider amending the Bill to permit paid executives to be appointed to trustee Boards with the safeguards suggested above.

Managing conflicts of interest and independence

It is often the case that public bodies require that they have representatives on the Boards of charities that deliver public services for them.

This is understandable; but it can lead to problems with the relationship, since representatives must understand that, when acting as a Board member of a charity, they must act in the best interests of the charity and not of the public body. This can cause tensions that have been explored very thoroughly by the Charity Commission in its publications, in particular CC29 – Charities and Local Authorities; and CC24 – Users on Board - Beneficiaries who become Trustees. It should be a condition of all contracts between public bodies and charities delivering public services for them that they must comply with the Charity Commission's best practice guidance on management of conflicts of interests in those circumstances.

Connected to this is the issue of independence. The Commission publishes guidance on this issue in RR7 – The independence of Charities from the State. Furthermore, the Trafford Community Leisure Trust and Wigan Leisure and Culture Trust decisions[313] state[314] that independence from the State is fundamental to the charitable status of any organisation. This is primarily because trustees must act solely in the best interests of their charity and maintain free discretion about how they might most effectively exploit their charity's resources in the discharge of its objects to the best advantage of its beneficiaries[315]. They cannot derogate from these duties, and they can only delegate their powers to the extent permitted in their constitution[316]. Accordingly, charities wishing to contract with public bodies for the delivery of public services must ensure that they maintain independence at least to the extent required to maintain charitable status. As a result, they should have due regard to the requirements of CC4, CC37 and RR7 and the Trafford and Wigan decisions.

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313 See above.

314 At paragraph 4.

315 Charity Commission Publication RR7 – The Independence of Charities from the State, paragraph 11.

316 See, for instance, Tudor on Charities (9th Edition), 6-017 and 6-020.

RR7 sets out a series of criteria that might be used to determine if a body has been created for a non-charitable purpose conferring non-charitable benefits on the public body; and to establish that the charity is as a matter of practice independent from the public body.

Clearly, before any charity can properly enter into any contract for the delivery of public services, it must have adequately addressed and managed these issues about conflicts of interest and independence. It is quite possible, however, that public bodies in their negotiations will not respect these issues, or that hard-pressed or poorly advised trustees might enter into arrangements which undermine its charitable status or prejudice its effective management in the best interests of its beneficiaries.

A Compact Code of Conduct on Conflicts of Interest might therefore usefully be devised that might require, as a minimum, that:

- no more than one representative of any one public body can be appointed to a charity Board at any one time
- the public body representatives on a Board may not together comprise more than 16% of the Board at any one time[317]
- a local authority may not enter into arrangements with a charity that delivers public services for it that would make it a local authority controlled company or a local authority influenced company pursuant to the Local Government and Housing Act 1989 or the Local Authorities (Companies) Order 1995
- all obligations of the charity to the public body should be set out clearly in writing and agreed to by the charity, with the public body representative being absent from the meeting while the obligations are being discussed
- the public body representative may be present at discussions concerning the public body, but may not vote on any issues relating to it
- the independence of charities from public bodies should be respected and maintained
- the confidentiality of a charity's confidential information should be respected and maintained
- due regard should be had to RR7 – The Independence of Charities from the State.

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[317] To safeguard against some of the thresholds in the Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995.

The Compact has furthered the cause of the delivery of public services by charities. Further work should be done in this area to clarify how the issues discussed above should be dealt with.

CHAPTER 8

CHARITIES AND TRADING

The Cabinet Office Private Action, Public Benefit Review recommended that the trading restrictions on charities should be de-regulated and that charities should be able to trade freely subject to a statutory duty of care[318]. Recommendation 3 of the Review stated that charity law should be amended:

> "…to allow charities to undertake all trading within the charity, without the need for a trading company. The power to undertake trade would be subject to a specific statutory duty of care".

This recommendation was not taken up by the Home Office in the Bill, but the Joint Committee recommended[319] that:

> "The draft Bill should be amended to allow charities to trade within the charity and enjoy tax exemption on trading income up to the point where income from trading equals 25% (or £5,000 if the greater) of the charity's total turnover, but this should be subject to an overall limit

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[318] The Cabinet Office Private Action, Public Benefit review listed a number of duties around trading. Arguably, they were encapsulated in a proper application of the duty of care in the Trustee Act 2000 in any event. These duties were: a duty to give proper consideration to the need to structure the trade in a way which does not expose the assets of the charity to significant risk; a duty to take proper (professional) advice in connection with the establishment, exercise and discontinuance of the trade; a duty to consider the suitability to the charity of trading as a form of income generation, and to consider the suitability for that purpose of the particular trade or proposed trade; and a duty to compare the economic benefits of the trade or proposed trade with other forms of income generation open to the charity. This could be a legal minefield for trustees.

[319] Joint Committee Report, paragraph 354.

higher than the current £50,000 and the Government should consult on the level at which that overall limit should be set."

This recommendation was made in response to a number of written representations to the Joint Committee, and particularly from acevo[320].

While in principle any reasonable de-regulation that is consistent with maintaining the integrity of, and the public confidence in, the sector is to be welcomed, any extension of the power of a charity to trade must be approached cautiously.

First, it should be recognised that, subject to appropriate powers being included in their constitutions, charities already have the power to trade when that trade furthers their primary purpose. This is known as "primary purpose" trade, and would include, for instance, a housing charity selling housing advice services to a local authority, or an independent school charging fees. Charities can also trade where the trade is "ancillary" to the primary purpose. Ancillary trading would include, for instance, a theatre charity established for the promotion of education in the Arts running a café bar during the interval.

If the café bar was open to the general public as well, then this would be a mixture of ancillary trade and non-primary purpose trade, and would amount to "mixed trading". Mixed trading and other limited non-primary purpose trading by charities (known as "small trading") are permitted by the Inland Revenue subject to certain prescribed limits[321].

Because of these restrictions, charities with substantial trading activities, or with non-primary purpose trades that exceed the prescribed limits or which do not have powers in their constitutions to trade, typically establish trading subsidiaries through which they carry out trade or other non-charitable activities. There are five key disadvantages to this:

- there is an additional administrative burden
- there are issues that need to be addressed around Board composition, the inter-relationship of the trading subsidiary Board and the charity Board and good governance
- there are difficulties in financing the trading subsidiary because the charity must treat any loan or payment to the trading subsidiary as an investment
- typically a trading subsidiary will Gift Aid its taxable profits up to the charity, so that the subsidiary obtains a 100% tax deduction against those profits. This can cause cashflow problems, but it is always

[320] See, for instance, Joint Committee Report, DCH 3, Memorandum from Association of Chief Executives of Voluntary Organisations; and DCH 174, Supplementary Memorandum from Association of Chief Executives of Voluntary Organisations.

[321] See, for instance, Inland Revenue Website, Charities and Tax, Annex IV.

open to the subsidiary only to Gift Aid some (but not all) of its taxable profits, and to retain a balance for working capital, although this retention would be subject to tax

- there are difficulties in formulating statements about what proceeds will be applied for the benefit of the controlling charity when the trading subsidiary enters into arrangements with commercial partners for promotional campaigns[322].

There is no doubt that these are issues that cause real cost and inconvenience for charities. A detailed exposition of the cost and inconvenience issues in the trading subsidiary context is set out in the acevo evidence to the Joint Committee[323].

While these are important concerns, on balance they are over-ridden by the following factors:

- it is good practice for the risks any substantial non-primary purpose trading activities generally to be ring-fenced from charitable assets

- before investing in the financing of non-primary purpose trade, trustees should have to consider their investment prudently and to determine that it is in the best interests of the charity

- there would be legitimate grievances from the private sector if charities are able to carry out substantial non-primary purpose trade and are able to re-invest the resulting untaxed profit in furtherance of that trade (i.e. not in a charitable trade). On one analysis this amounts to a Government subsidy of a non-charitable trade

- to the extent that the taxable element of this profit exceeded the de minimis provisions for State Aid in respect of any charity and the trade had a European cross-border effect, it might in certain circumstances amount to State Aid and therefore be illegal

- one of the advantages of a trading subsidiary is that more "commercially astute" directors can be put in place to manage the charity's trading activities. The look and feel of the trading subsidiary Board should therefore be different. The charity Board, however, may not effect such a transition while at the same time expanding its trade. As a result, a lack of commercial acumen might result in insolvency – even a failed trade that comprised only 25% of turnover might be sufficient to bring a charity down, depending on its margin, cash flow and commitments to beneficiaries

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322 See Chapter 9 below.

323 See especially Supplementary Memorandum from the Association of Chief Executives of Voluntary organisations (ACEVO) (DCH 174) Ev 31.

- there would be enhanced capability for fraud and misapplication of funds, which might undermine public confidence in the sector

- the enhanced risk of fraud, insolvency and charitable donations being applied to non-primary purpose trade rather than beneficiaries might erode public confidence in the sector in the long-term if this risk were realised

- the Commission will have an additional burden of monitoring trading activities in the charity; a task that might previously have been left to Companies House in circumstances where this trade was channelled through a trading subsidiary. It is not clear that the Commission is properly equipped or funded to carry out that task.

For this reason, and with due respect for the legitimate concerns of acevo, de-regulation of the trading restrictions on charities should be adopted only very cautiously. In any event, any upper limit should be set conservatively. At the end of the day, a trading subsidiary structure is a prudent device to shield charitable assets from trading risks. Its disadvantages are considerably outweighed by its substantial advantages. They are an acceptable price to pay for continued public confidence in the sector.

This approach was adopted by Government in its Reply to the Joint Committee Report[324]. It stated, for instance, that:

> "An increased limit would mean that considerably more trading could be carried out by charities tax free, giving them a greater competitive advantage over small businesses which are taxed on their profits. Trading companies have the option to donate their profits to charity, and so start from a similar position whether they are subsidiaries of charities or not. It would be unfair to give charities greater exemptions from the requirements normal commercial businesses have to meet."

One possible solution to this conundrum might be to relax the rules around the way in which charities can "invest" in their trading subsidiaries rather than de-regulate the way in which charities can trade themselves. Such a regime might overcome all of the perceived difficulties set out above, and might allow a charity to make payments to its trading subsidiary for that subsidiary's trading purposes, provided that:

- the charity's constitution did not expressly prohibit making such a payment

- the trustees complied with a statutory duty of care analogous to that in the Trustee Act 2000[325]

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[324] Paragraph 42, at page 17.

[325] The duty of care in the Trustee Act 2000 is set out in S1. It is the "exercise such care and skill [by a trustee] as is reasonable in the circumstances, having regard in particular-

- no more than 25% of the charity's total income in any year was paid to the trading subsidiary in this way
- payments could be made without interest but on terms that the capital sum should be repaid within a reasonable period taking into account all the relevant circumstances.

(a) to any special knowledge or experience that he has or holds himself out as having, and

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession."

CHAPTER 9

OTHER ISSUES ARISING FROM THE BILL

Apart from the issues about the Bill discussed in previous chapters, the Bill deals (or in some cases does not deal) with a considerable number of other issues, including:

- registration of charities
- application of property cy-près
- assistance and supervision of charities by the Court and by the Commission
- audit and examination of accounts where the charity is not a company
- charitable companies
- issues around the remuneration and liability of trustees
- powers to spend capital
- mergers
- public charitable collections
- financial assistance for charities by the Secretary of State.

Many of these provisions, while technical, are commendable. Some suggestions on these and some other provisions of the Bill are set out below. Note that the provisions in Chapter 1 of Part 3 of the Bill relating to public charitable collections are not dealt with at all in this paper. The comments below are made with only the briefest description of context. Since they are technical (but important), this paper hopes that those sufficiently interested will consider the suggestions against the text of the Bill itself.

- **Section 2(4)(b) – Application of double analogy principle to S2(2)(a)-(k) –** Due to the negative context of the reference to S2(2)(a)-(k) in S2(4)(a), and to the fact that it is unclear that the reference in S2(4)(b) to "those paragraphs" refers to S2(2)(a)-(k), it is arguable that those subsections do not "fall within" S2(4)(a) for the purposes of S2(4)(b). This is clearly not the intent, and the drafting of S2(4)(a) and (b) should be clarified to avoid any ambiguity.

- **Section 2(6) – Definition of "charity law" –** This definition should be expanded to make expressly clear that the law relating to charities in England and Wales means the law relating to charities in England and Wales from time to time.

- **Section 3(3) – Definition of public benefit –** This Section should be amended to ensure that any reference to the public benefit is to the public benefit as that term is understood for the purposes of the law relating to charities in England and Wales from time to time.

- **Section 18/14B(3)(c) – Cy-près schemes -** Surely the impact should be broader potentially? A conservation charity to be effective might not need to demonstrate a social or economic impact, but merely an environmental one.

- **Section 22/20A(5) – Publicity for orders relating to appointment, discharge or removal of trustees or other individuals –** The Commission should be obliged to make reasonable enquiries as to the whereabouts of the person. It may not be their own fault that they cannot easily be found.

- **Section 26/31A – Power of Commission to enter premises in the context of a S8 investigation –** There should be an obligation for the Commission to be accompanied by a police officer unless the Commission has good reason to believe that is not necessary. The police are expert in entering premises under warrant in potentially adverse circumstances. The Commission is not. Additionally, Lord Hodgson made the point in Grand Committee[326] that a receipt should be required to be given in respect of any documents or materials removed by the Commission under S26 of the Bill, and this has been provided for in S26/31A(6) and (7). This paper supports that position.

- **Section 34/73A – Provisions empowering remuneration of a charity trustee –** Is it clear that, from a company law perspective, this provision will prevail where there is no express power in a charitable company's constitution accommodating it?

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[326] Hansard (Lords), 14 March 2005 at column GC435.

- **Section 34/73B(3) – Agreement in force for the purposes of ascertaining how many trustees are benefiting –** There might be non-financial residual provisions that remain in force, which should surely not be taken into account in these circumstances. Examples might include ongoing confidentiality and data protection clauses.

- **S37 – Trustee Indemnity Insurance –** Is it clear that, from a company law perspective, this provision will prevail where there is no express power in a charitable company's constitution accommodating it?

- **Section 38/74(4) - Power of unincorporated charities with gross income not exceeding £10,000 to transfer all property to another charity -** Before trustees can pass a transferring resolution they should also be required to ensure that all necessary third party consents to the transfer have been obtained and remain valid. Trustees who proceed on this basis without legal advice might overlook the fact that, while the Bill empowers them to take this action, certain third party consents might also be required. Failure to do this might result in serious consequences for key contracts, including leases: just because a charity does not have an income exceeding £10,000 does not mean it does not have a lease. The situation has been dealt with elsewhere: see, for instance, S21/9B(5) and S42/75D(3)(b).

- **Section 38/74(12) – Power of Commission to transfer property from one unincorporated charity to another –** The same issue arises.

- **Section 38/74A(2) – Right of Commission to object to resolution – resolution ineffective as a result –** This objection can be appealed to the CAT under Schedule 4. On a literal interpretation of this Section the charity will have to pass a new resolution even if the appeal is successful. That would be regrettable.

- **Section 38/74A(6) – Resolutions transferring property of unincorporated charities that do not take effect or that take effect at a later date -** Under this Section if certain prescribed events do not occur, the resolution transferring the property shall be treated as if it had never been passed. The Commission should have a power to extend the relevant time period of 120 days if it considers that there are circumstances warranting that extension.

- **Section 41/75A(9)(a) – Power of larger unincorporated charities to spend capital given with one purpose – Commission decision to concur with resolution of trustees –** This Section means that the Commission cannot concur with the resolution unless its implementation would accord with the spirit of the relevant gift. This provision should be amended so that it refers to "the spirit of the relevant gift taking into consideration the matters in S75A(8)(b)".

Those matters are "any changes in the circumstances relating to the charity since the making of the gift or gifts (including, in particular, its financial position, the needs of its beneficiaries, and the social, economic and legal environment in which it operates)". Without such a context, the concept of the "spirit of the gift" may be insufficiently flexible to achieve the intent behind this provision.

- **Section 42/75C(4) – Charity mergers – register of charity mergers – definition of "relevant charity merger" –** This definition is problematic. First, there is no limit on how long after a transfer for merger purposes a transferee can continue to exist; and secondly as a result the transfer may never comprise a relevant charity merger even though a merger has in fact taken place. This must be clarified. Additionally, **Sub-section (7)** should also require the entries in the register to specify whether the relevant charities have ceased to exist, and if so on what date they ceased to exist. Leaving this to a "catch all" that "each of the entries in the register shall… (b) contain such other particulars of the merger as the Commission thinks fit" is not sufficient, especially since the definition of a "merger" requires cessation of existence.

- **Section 68(10)(b) and Section 67(9)(b) – Definition of "charitable, benevolent or philanthropic institution" -** This is partly tautologous with sub-section (a) in each case since if a body is established for charitable purposes, then it is a charity. If what is meant is a body that it is set up for charitable purposes that are partly, but not exclusively, charitable, then the Section should say so.

- **Schedule 2, Section 3(1) and (2) – Establishment of the Charity Commission – effects of transfers under Section 6 -** There appears to be an important lacuna in this Section. S3(1) states that anything which has been done in relation to the Commissioners and is in effect immediately before commencement [of the Section] is to be treated as if done by or in relation to the Commission. S3(2), however, states that anything (including legal proceedings) which relates to anything transferred by section 6(4) and is in the process of being done by or in relation to the Commissioners, may [but not "must"] be continued by or in relation to the Commission. This provision therefore might entitle the Commission to disclaim any liability, say, for mal-administration by the Commissioners which had not transpired into something "done and in effect". This lacuna must be addressed.

- **Schedule 6/Part 8A/69B(5) – Determining form of constitution of CIO –** This Section provides that a CIO's constitution shall be in the form specified in regulations made by the Commission, or as near to that form as the circumstances admit. The key concern here is that the Commission may become bogged down in negotiations with applicants all seeking variations to the regulation form and making appeals to the CAT if the Commission refuses to register the CIO because of any

discrepancy in agreement about what the "circumstances permit". Is the Commission equipped and ready for the implications of this provision?

- **Schedule 6/Part 8A/S69H – General –** Would it be appropriate of the face of the Bill to make clear that applications for conversion must be accepted by the Commission unless the provisions of S69H(2), (3) and (4) apply?

- **Schedule 6/Part 8A/S69I – Conversion – registration -** It should be made clear that the Commission has the power to transfer the charity number of the converting charity to the new CIO?

- **Schedule 6/Part 8A/S69J - Transfers of assets to CIO** - **third party rights** - The issue about making provision for the rights of third parties applies here as discussed with respect to S38/74(4) above. It also applies to **Schedule 6/Part 8A/S69K(3),S69L(8) and S69N**.

- **Schedule 6/Part 8A/S69J (9) and (10) – Criteria for refusal of application for amalgamation of CIOs –** While a notice under S69J(7) must invite any person who considers that he would be affected by the proposed amalgamation to make written representations to the Commission, it does not appear that the Commission can refuse the application on the grounds of such a representation, unless they relate to the matters set out at S69J (9) or (10). It should be able to do so.

- **Schedule 6/Schedule 5A, S3 – Constitutional requirements for CIOs –** What is the contractual position with guarantee companies with no material guarantee; or with companies in respect of which shares have been cancelled pursuant to S69I(5)?

  Finally on this point, more consideration should be given as to whether a CIO could be established without members, but only with trustees. Government resisted this approach in Grand Committee[327] on the basis that the "unitarian" benefits of this approach would be outweighed by its disadvantages and by legal obstacles. It was not made clear what these disadvantages and obstacles are.

- **Schedule 6/Schedule 5A Section 14(5) and Section 15(5) – Amendment of CIO constitution -** These two Sections are inconsistent. S14(5) states that a resolution containing an amendment which would make any regulated alteration (as defined) is to that extent ineffective unless the prior written consent of the Commission has been obtained to the making of the amendment. S15(5) states that the Commission may refuse to register an amendment if it would make a

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[327] Hansard (Lords), 14 March 2005, from column GC465.

regulated alteration and the consent under S14(5) has not been obtained. If this consent has not been obtained, however, then according to S14(5) the resolution is ineffective so the Commission would have no option but to refuse registration until a new resolution had been passed. If the intent behind S15(5) is that the Commission can "activate" a resolution that is ineffective pursuant to S14(5) then the Section should say so.

Arrangements with Commercial Participators under the Charities Act 1992

Finally, this paper considers the failure of the Bill to take the opportunity to address certain difficulties with the arrangements under the Charities Act 1992 relating to "commercial participators" who enter into promotional ventures in the course of which it is represented that proceeds from the venture will be applied for the benefit of a charity.

The regulatory regime

S59(2) of the 1992 Act states that it is unlawful for a commercial participator to represent that charitable contributions are to be given to or applied for the benefit of a charitable institution unless he does so in accordance with an agreement with the institution satisfying the prescribed requirements[328]. If this does not happen, then the charitable institution concerned may apply to the Court for an injunction restraining any ongoing contravention pursuant to S59(3).

Furthermore, by S59(4), if any agreement is made between the commercial participator and the charitable institution whereby the commercial participator is authorised to represent that charitable contributions are to be given to or applied for the benefit of the institution and the agreement does not satisfy the prescribed requirements[329] in any respect, then the agreement shall not be enforceable against the institution except to the extent (if any) provided by an order of the Court.

Equally, S59(5) provides that a commercial participator who is a party to a commercial participator agreement may not receive any remuneration or expenses unless he is entitled to do so under any provision of the agreement, and either the agreement satisfies the prescribed requirements or an order of the Court is made to that effect.

For these purposes[330]:

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[328] See below for definition of "prescribed requirements".

[329] See below for definition of "prescribed requirements".

[330] See Charities Act 1992, S58.

- "commercial participator" means, in relation to any charitable institution, any person (apart from a company connected with the institution[331]) who carries on for gain a business other than a fund-raising business, but, in the course of that business, engages in any promotional venture in the course of which it is represented that charitable contributions are to be given to or applied for the benefit of the institution

- "promotional venture" means any advertising or sales campaign or any other venture undertaken for promotional purposes

- "fund-raising business" means any business carried on for gain and wholly or primarily engaged in soliciting or otherwise procuring money or other property for charitable, benevolent or philanthropic purposes

- "charitable institution" means a charity or an institution (other than a charity) which is established for charitable, benevolent or philanthropic purposes; and for these purposes a charity means[332] any institution, corporate or not, which is established for charitable purposes and is subject to the control of the High Court in the exercise of the Court's jurisdiction with respect to charities

- "prescribed requirements" are currently the relevant requirements set out in the Charitable Institutions (Fund-raising) Regulations 1994 (SI 1994/3024), Section 3.

A further safeguard for charities engaging with commercial participators[333] is that where any representation is made by a commercial participator to the effect that charitable contributions are to be given to or applied for the benefit of one or more particular charitable institutions, then the representation shall be accompanied by a statement clearly indicating:

- the name of the institution concerned

- if more than one institution, the proportions in which they will benefit

- (in general terms) the method by which it is to be determined:

    - what proportion of the consideration given for goods or services sold or supplied by him, or of any other proceeds of a promotional venture undertaken by him, is to be given to or applied for the benefit of the institution or institutions concerned

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331 For instance, a charity's wholly-owned trading subsidiary.

332 See Charities Act 1993, S96(1).

333 Charities Act 1992, S60(3).

- what sums by way of donations by him in connection with the sale or supply of any such goods or services are to be so given or applied

Failure to comply with this provision is an offence[334].

The "in general terms" provision about the proportion of consideration to be declared was generally considered to be open to abuse. As a result, S65(4) of the Bill proposes to amend S60(3)(c) of the 1992 Act by requiring that a "notifiable amount" must be stated. The notifiable amount to be stated in the commercial participator context[335] must be:

- the sum representing so much of the consideration given for goods or services sold or supplied by him as is to be given or applied for the benefit of the institution or institutions concerned

- the sum representing so much of any other proceeds of a promotional venture undertaken by him as is to be so given or applied

- the sum of the donations by him in connection with the sale or supply of any such goods or services which are to be so given or supplied

being the actual amount of the sum, if that is known at the time when the statement is made, and otherwise the estimated amount of the sum, calculated as accurately as is reasonably possible in the circumstances.

Paragraph 7 of the Charitable Institutions (Fund-raising) Regulations 1994 attempts to provide further protection. It applies to any person who carries on for gain a business other than a fund-raising business but, in the course of that business, engages in any promotional venture in the course of which it is represented that charitable contributions are to be applied for charitable, benevolent or philanthropic purposes of any description (rather than for the benefit of one or more particular charitable institutions)[336]. In these circumstances similar requirements to those above apply, and failure to comply is an offence[337].

Problems with the regulatory regime

The key difficulty with this regulatory regime is that many charities engage in promotional ventures through their trading subsidiaries, which will of course

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334 By Charities Act 1992, S60(7).

335 There are slightly different requirements for professional fundraisers to notify their remuneration.

336 This reflects S60(2) of the 1992 Act which applies to professional fundraisers but not to other people engaging in a promotional venture.

337 Paragraph 8.

not be "charitable institutions" for the purposes of the 1992 Act[338]. As a result, a "commercial participator" agreement will not usually be obligatory. Best practice, however, suggests that a trading subsidiary should enter into an agreement analogous to a commercial participator agreement in any event.

This is reflected in Commission publication CC20 – Charities and Fund-raising[339] which states[340] that:

> "The [commercial participator] rules do not apply to fund-raising by a charity itself or, for most purposes, by a connected company, i.e. one wholly owned or controlled by one or more charities. However we recommend that the company comply with the legal requirements as a matter of good practice".

Equally, Commission publication RS2 – Charities and Commercial Partners[341] states that while there are no adverse statutory implications for a charity not to comply with Ss59 or 60, since all statutory burden is on the commercial participator, it remains a charity's moral duty to inform commercial participators or quasi-commercial participators about the legal position and ensure they comply.

A number of issues arise from this:

- a trading subsidiary may be engaging in promotional ventures with commercial third parties by means of a trade mark licence agreement from its charity, and so the charity will have a fundamental interest in the way the trading subsidiary and the third parties apply the trade mark commercially. It may be that the trading subsidiary's arrangement with a third party engaged in a promotional venture using the charity's name is insufficient, and the consequent implications may adversely impact upon the charity

- it may be more expedient for a charity trading subsidiary to take proceedings under S59 than for the charity itself

- where a (quasi-) commercial participator contracts with a trading subsidiary, whether or not S60 has been contravened will depend very much on the statement made by that participator in the context of the relevant promotional venture. A statement that the proceeds will be applied for the benefit of the charity will technically contravene S60 unless all of the sums received by the trading subsidiary are remitted to

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338 It might be possible to frame the objects of a charity's trading subsidiary in a way that made it an institution established for benevolent or philanthropic purposes (albeit not a charity), which fulfilled its mission through commercial trade. This is not clear, however.

339 July 2002.

340 At paragraph 42.

341 July 2002.

the charity[342]. It is less clear, however, whether a statement that "all proceeds will go to charity X's trading subsidiary" is a representation that the relevant charitable contributions are to be given to or applied for the benefit of the charity. Technically not, since they are different entities; but in the mind of the public the trading subsidiary and the charity may be the same. It is unlikely that the average member of the public will have regard to or understand the distinction between a charity and its trading subsidiary. The position is unsatisfactory

- Again, while it is arguable that the 1994 Regulations are intended to apply to representations that charitable contributions will be made to charity trading subsidiaries, this may not always be the case because such subsidiaries will often be constituted for commercial purposes and not charitable, benevolent or philanthropic ones

- There is a lack of clarity about who should bring criminal proceedings under this legislation; and a lack of will by those who might be most appropriate to do so (e.g. trading standards). This should be addressed

- S6 of the 1994 Regulations sets out certain requirements under which monies must be paid by a commercial participator to the relevant charitable institution. If, however, a quasi-commercial participator has made an agreement with the charitable institution's trading subsidiary rather than the charitable institution and the representation is made that sums will go to the trading subsidiary, it is not clear that either the charitable institution or its trading subsidiary can enjoy the protection of this provision

- The deficiencies of this regime are often bypassed by effecting a tripartite structure so that a commercial participator must contract both with a charity and its trading subsidiary, the agreement with the charity amounting to a "bare minimum" commercial participator agreement. This is highly unsatisfactory in many circumstances, however, since it can (i) cause extra costs for the charity; (ii) lead to concerns of the commercial participator about its primary contractor and to whom it owes liability; and (iii) give rise to issues about trading and licensing of brands and logos by the charity.

In the light of the above, this paper suggests that the regulatory regime in Ss59-60 of the Charities Act 1992 should be clarified. In particular:

- S59(2) and S60(3) of the 1992 Act should be amended to include contributions that are given to or applied for the benefit of the charitable

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[342] On an extremely purist argument, depending on what statement is made, the very same proceeds ought properly to be remitted to the charity.

institution or any body controlled[343] by it where more than 50% of the profits of that body are to be donated (by whatever means) to the charitable institution

- With the consent of the charitable institution, any body controlled by it which has entered into an agreement analogous to one required by S59(2) with a commercial participator should be able to bring an application pursuant to S59(3)

- The definition of "notifiable amount" in S64(5)/(3A) of the Bill should be amended so that where the actual amount of the sum is not known, the obligation to notify the "estimated amount" should be to the estimated amount of the sum, calculated as accurately as is reasonably possible in the circumstances, and if such an estimate is not reasonably possible, then the method by which the sum is to be determined in reasonable detail". Estimates of income can be notoriously hard to make at the outset; and overly-optimistic estimates (which may at the time they were made not have been unreasonable) given in the first flush of enthusiasm for a project may ultimately be damaging to all concerned. This position is exacerbated when the relevant funds are routed through a charity's trading subsidiary. How can it be said with any clarity by the commercial participator by what amount the charity will benefit? This will of course depend upon the amount of taxable profit in the subsidiary at the end of the year in which the sums were received and the extent to which it determines to donate that profit to the charity

- S6 of the 1994 Regulations should be amended to make clear that both charities and their trading subsidiaries can enjoy its protection even where the relevant agreement is made with the trading subsidiary and not the charity.

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[343] "Control" to be defined. Perhaps the definition in Schedule 5, Section 3 of the Charities Act 1993 might be used. Alternatively, the broad definition in S435(10) of the Insolvency Act 1986 is a possibility.

CHAPTER 10

CONCLUSION

The Charities Bill makes welcome technical enhancements to the legislative framework for charities. It is unfortunate, however, that Government does not appear to take the opportunity presented by the Bill to tackle some of the structural problems facing the charitable sector. Neither does it appear to have factored in any time for a consolidating Bill[344], as one result of the new legislation will be that the law will be difficult to read and interpret.

Aside from this, it is not clear that some of the innovations of the Bill are necessary, or what their impact will be. For instance, the abolition of the presumption of pubic benefit appears to herald uncertainty – particularly in the educational context – which cannot be in the best interests of the development of the sector; and it is not clear what its effect on the workload or operations of the new Charity Commission will be.

Equally, it is not clear that the Charitable Incorporated Organisation adds much to the pre-existing Company Limited by Guarantee, or whether the time and expenditure in implementing it will be worthwhile. There are also a number of concerns around the constitution of the Charity Appeal Tribunal.

The Bill demonstrates a tendency towards the over-regulation of the charitable sector, particularly in the fundraising context, which could stifle rather than enhance the ability of charities to obtain innovative new income

[344] A consolidating Bill has been recommended by the Joint Committee. See Joint Committee Report, paragraphs 383 and 384. This Recommendation was rejected by Government in its Reply to the Joint Committee Report (paragraph 48, at page 18) on the grounds that consolidation was the responsibility of the Law Commission.

streams and reach out to new supporters. While proportionate regulation is important for the sector's health and vitality, over-regulation will undermine it, and must be prevented.

Again, the Bill fails to address the recoverability of irrecoverable VAT, worth over £460 million each year to charities; and the improvement of the structure of the sector the better to enable it to deliver public services and to "professionalise" itself in order to address future challenges and build capacity.

Equally, the Joint Committee has raised again the question of the de-regulation of the trading regime for charities; but the burden of the attendant risks appears to outweigh any benefits that de-regulation might bring. As a result, de-regulation should be modest, and should only occur after careful thought about its implications.

Finally, the Bill raises a considerable number of smaller (but still important) conceptual and drafting issues that must be addressed. In that context, it has also failed to take the opportunity to address some of the difficulties with the regulatory regime around commercial participators under the Charities Act 1992.

This paper has sought to highlight some of these issues. It does not profess to have all the answers; but it does proffer some suggestions, and in so doing to contribute to the healthy debate that thrives throughout the sector. As we work together, we can lay the foundations upon which an ever more innovative, progressive, efficient and effective charity sector can be built.

Annex

Part A

List of Charitable Purposes under S2(2) of the Charities Bill

- The prevention or relief of poverty
- the advancement of education
- the advancement of religion, including a religion which involves belief in more than one god, and a religion which does not involve belief in a god
- the advancement of health (including the prevention or relief of sickness, disease or human suffering) or the saving of lives
- the advancement of citizenship or community development (including rural or urban regeneration and the promotion of civic responsibility, volunteering, the voluntary sector or the effectiveness or efficiency of charities)
- the advancement of the arts, culture, heritage or science
- the advancement of amateur sport involving physical skill and exertion
- the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
- the advancement of environmental protection or improvement
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage, including relief given by the provision of accommodation or care
- the advancement of animal welfare
- any other purposes within S2(4) of the Bill (see Chapter 2 above and Part B of this Annex below).

Part B

How Charitable Purposes are currently determined under English Law

The current law

Until the day on which S2 of the Bill comes into force, what comprises a charitable purpose under the current law is determined by the Commission or by the High Court[345] from time to time.

New charitable purposes are determined, first, by direct reference to the Statute of Elizabeth and Pemsel's Case[346]. Secondly, the Courts will draw analogies to these purposes. Thirdly, they will also draw analogies from these analogies (the so-called "double analogy" principle). An example of judicial thinking in this regard was given by Lord Reid in the Scottish Burial Reform case[347]:

> "The appellants must show, however, that the public benefit is of a kind within the spirit and intendment of the Statute of Elizabeth. The preamble specifies a number of objects which were then recognised as charitable. But in more recent times a wide variety of other objects have come to be recognised as also being charitable. The Courts appear to have proceeded first by seeking some analogy between an object mentioned in the preamble and the object with regard to which they had to reach a decision. Then the appear to have gone farther, and to have been satisfied if they could find an analogy between an object already held to be charitable and the new object claimed to be charitable".

In its publication RR1a – Recognising New Charitable Purposes – the Commission states[348] that:

> "Although the Courts still use the preamble as a touchstone and refer to the Pemsel classification, they have long recognised that what is accepted as a charitable purpose must change to reflect current social

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345 The Commission has this power by virtue of S3(1) of the Charities Act 1993 which states that "the Commissioners shall continue to keep a register of charities, which shall be kept by them in such manner as they think fit". S3(2) of the 1993 Act requires that "there shall be entered into the register every charity not excepted by Sub-section (5)". S3(4) requires that "any institution which no longer appears to the Commission to be a charity shall be removed from the register".

346 See Chapter 1 above.

347 Scottish Burial Reform and Cremation Society Ltd v Glasgow City Corporation [1967] 3 All ER 215, at page 218 D-G.

348 At paragraphs 5 and 6.

> and economic circumstances. So a purpose will be charitable not only if it is within the list in the Preamble but also if it is analogous to any purpose either within it or since held to be charitable. Nowadays many charities are set up for purposes that are not mentioned in the Preamble.
>
> In this way charitable purposes have been extended and developed, by decisions of the Courts and of the Charity Commissioners, so that the development of the law has reflected changes in social and economic circumstances."

The Commission has previously considered a more innovative approach, and whether to abandon the "analogous purposes" principle in favour of a "novel purposes" approach as suggested by the following excerpts from RR1a:

> "In 1985 we reviewed our policy for deciding whether novel purposes are charitable (See Commissioners' Annual Report 1985 paras 24-27). Having examined the legal authorities, the Commissioners concluded that they must follow the courts' approach in seeking an analogy (In Barralet v Attorney General [1980] All ER, 926-7 per Dillon J)…
>
> The Commission will take a constructive approach in adapting the concept of charity to meet constantly evolving social needs and new ideas through which those needs can be met. Acting within the legal framework which governs the recognition of new charitable purposes, we would aim to act constructively and imaginatively.
>
> In effect, our view is that we will look for a suitable analogy in order to confirm whether or not the way in which a purpose will benefit the public is charitable. We also believe it will nearly always be possible to find an analogy, if the nature of the benefit is really of a kind that ought to be recognised as charitable…
>
> Other legal authorities suggest that analogy with specific purposes already accepted as charitable is not strictly needed but that a broader analogy with the kinds of purposes already accepted as charitable is sufficient… We will adopt this approach where there is a clear benefit to the public"[349].

This approach is confirmed by Tudor[350] who says that:

> "What is regarded as charitable develops and changes as the needs of society change. As Lord Simonds pointed out in National Anti-Vivisection Society v IRC ([1948] AC 31 at 74) a "purpose regarded in one age as charitable may in another be regarded differently…".

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[349] From RR1a – Recognising New Charitable Purposes (October 2001), paragraphs 23-25.

[350] Tudor on Charities (9th Edition, 2003), at paragraph 1-005.

> It is considered that the better view is that an analogy is required and that, in the absence of a specific analogy, a broader analogy can be taken. Any danger that this would result in too wide a category of charitable purposes is limited by the need to satisfy the requirement of public benefit…"[351].

Using this approach the Commission has recognised a number of new purposes over recent years, including, for instance[352]:

- the promotion of community capacity building
- the promotion of urban and rural re-generation
- environmental conservation
- the promotion of human rights
- good community relations
- the promotion of fair trade
- the promotion of ethical standards in business and corporate responsibility.

Charitable purposes and human rights

There are arguments that some restrictions on charitable purposes may amount in some circumstances to an infringement of the European Convention on Human Rights, and so the Human Rights Act 1998. This argument is typically most heated in the religious context, and an analysis of the argument is set out below.

Article 9.1 of the European Convention on Human Rights states that "Everyone has the right to freedom of thought, conscience and religion; this right includes freedom to change his religion or belief and freedom, either alone or in community with others and in public or private to manifest his religion or belief, in worship, teaching, practice and observance".

On the face of it, and without resorting to a detailed analysis of the jurisprudence on this subject, it is not clear how it might reasonably be said that the fact that some quasi-religious faiths are not recognised as charitable under English law – either because they do not comprise a "religion" or because, as a religion, they are not sufficiently established to, or for whatever other reason do not, fulfil the public benefit test – can result in an infringement of Article 9.1. The fact that such a faith is not charitable does not infringe the right to freedom of thought, conscience or religion, since the withholding of charitable status does not in itself restrain these.

It might also be argued that the right of "Non-Discrimination" in A14 of the Convention applies. A14 states that: "The enjoyment of the rights and

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[351] See below.

[352] From RR1 – Recognising New Charitable Purposes, Annex B.

freedoms set forth in this Convention[353] shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status".

At first blush this might appear to be problematic since any differentiation in respect of tax treatment amongst faiths that comprise a religion under the jurisprudence of the Convention might appear to be caught by this.

This is unlikely however, because Article 14 is a "parasitic" right which does not prohibit all discrimination by the State but merely prevents it from being discriminatory in the way in which it guarantees the other Convention rights[354]. Since there is no breach of Article 9.1 in itself through the application of charity law in England and Wales, Article 14 does not apply. It has also recently been held in a case before the European Court of Human Rights[355] that a difference in treatment is only discriminatory if it has no objective and reasonable justification: for instance if it does not pursue a legitimate aim or if there is no reasonable relationship of proportionality between the means employed and the aim sought to be realised. As a result, even if discrimination were an issue, there is no discrimination in the charity context because on the basis of this test the law of England and Wales comprises a sensible and objective assessment of what might be regarded as a religion for its own purposes and when that religion might be said to be for the public benefit.

Finally, it might be argued that the selective approach to charitable status imposed by the law amounts to a contravention of Article 1 of the ECHR, which provides that every legal person is entitled to the peaceful enjoyment of his possessions[356]. Denial of charitable status might be said to amount to a deprivation of fiscal benefits and so a contravention of Article 1. Article 1 is, however, qualified by the right of the State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest; and since charity has a fundamental public element it seems unlikely that the selective award of charitable status in accordance with rational, proportionate and coherent rules would be a contravention of Article 1.

On the basis of the above, therefore, the human rights arguments made by some in relation to the application of charity law with respect to religion appear to be unfounded.

Government adopts a robust stance on human rights issues arising in this context[357]; and this position should be supported.

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[353] E.g. including the rights with regard to religion in Article 9.1.

[354] See Clayton & Tomlinson (1st Edition), 2000.

[355] Camp & Bourimi v the Netherlands (2002) 34 EHRR 59.

[356] See, for instance, Tudor on Charities (9th Edition, 2003), at 1-009.

[357] See, for instance, Explanatory Notes to the Bill, paragraphs 255-258.

Part C

Legal arguments about the public benefit test

in the educational context

As discussed in Chapter 2 and 3 above, for a purpose to be charitable it must, first, fall within the legal definition of purposes that are capable of being charitable from time to time; and secondly, it must be for the public benefit. What comprises public benefit is currently ultimately determined by the Courts from time to time; and this position is maintained by S3 of the Bill.

The law of public benefit is complex, and this paper is not the place to discuss it thoroughly in detail. Suffice to say that there is a distinct body of jurisprudence as to what comprises public benefit in each of the four heads of charity under Pemsel's Case[358].

In that light, this paper now analyses the issue of the legal test for public benefit in the educational context, and attempts to explain the two different views about that test that have arisen. After this, the concordat between the Home Office and the Charity Commission will be analysed.

The "no change" argument

This argument is based upon the fact that applicable case law does not require wider access as a pre-requisite of public benefit in the educational context[359].

There is a long line of authority known as the "Schools Cases"[360] that suggest this is not necessary. This paper is not the place to embark upon a detailed analysis of the Schools Cases, but three illustrative examples of the approach taken by the Courts are set out below:

> "The institution of a school for the sons of gentlemen is not, in popular language, a charity; but in the view of the Statute of Elizabeth, all schools for learning are so to be considered"[361].
>
> "Brighton College is none the less in legal language a charity, because it was established as a school for the sons of noblemen and

[358] See above.

[359] This paper is indebted in this context to the arguments of Guy Newey QC in his section of the paper *Charities that Charge: the Impact of the Strategy Unit Report and the Charities Bill 2004*.

[360] See for example AG v Earl of Lonsdale [1824-34] All ER 666; Brighton College v Marriott [1925] All ER 600; The Abbey, Malvern Wells Limited v Minister for Town and Country Planning [1951] 2 All ER 154; Campbell College, Belfast v Northern Ireland Valuation Commissioner [1964] 1 WLR 912.

[361] AG v Earl of Lonsdale, supra, per Leach VC.

> gentlemen; nor does the institution lose its charitable character, nor do its activities become a trade, occupation or business merely because fees are charged for the education which the scholars at the College receive"[362].
>
> "The category of education is charitable in its own right, without any necessity to find an eleemosynary[363] element in any particular form of education. I should not of myself call this a special or technical meaning of the word "charitable" as contrasted with the alleged "popular" meaning which has so often been referred to but never defined"[364].

None of these cases suggests that wider access is necessary for these educational establishments to retain their charitable status. Indeed, as a result of these cases there is a strong argument that the abolition of the presumption of public benefit for educational charities would not suddenly enable the charitable status of independent schools to be challenged on public benefit grounds because they did not offer wider access.

Re Resch[365] is regularly held up as providing justification for the charging of fees and the consideration of both direct and indirect public benefit (including relief of the state sector) when determining public benefit. There are problems, however, with the application of Re Resch to the context of independent schools, and these are explored further below.

The "no change" argument has been re-enforced by a number of eminent senior legal practitioners, including Hubert Picarda QC[366]. Equally, the leading textbooks make no mention that wider access is a pre-requisite for educational charities to pass the public benefit test[367].

Cases have tended to take a similar approach:

> "The status of some of the "poor relations" trusts as valid charitable trusts was recognised more that 200 years ago and a few of those then recognised are still being administered as charities today. In In re

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362 Brighton College v Marriott, supra, per Lord Blanesburgh.

363 Shorter Oxford Dictionary: adjective: "Of the nature of alms; charitable". See also Picarda on the Law and Practice Relating to Charities (3rd Ed., 1999, Chapter 31 at page 403), who states that eleemosynary corporations are "constituted for the perpetual distribution of free alms or bounty of the founder to such persons as he has decided".

364 Campbell College, Belfast v Northern Ireland Valuation Commissioner, supra, per Viscount Radcliffe.

365 Re Resch, or more properly Le Cras v Perpetual Trustee Co Ltd [1967] 3 All ER 915. It was held that the provision of medical care for the sick was a public benefit in itself so that the purposes of a hospital were prima facie charitable as long as there was no commercial profit to be applied for non-charitable purposes. Equally, a charity for the relief of the sick did not have to be limited to the relief of the poor to be valid. The test was rather one of public benefit.

366 Joint Committee Report, Volume III, Memorandum from Hubert Picarda QC [DCH 297].

367 See, for instance, Tudor on Charities (9th Edition, 2003).

> Compton Lord Greene MR said… that it was "quite impossible" for the Court of Appeal to overrule such old decisions and in Oppenheim… Lord Simmonds in speaking of them remarked… at the unwisdom of casting doubt on "decisions of respectable antiquity in order to introduce a greater harmony into the law of charity as a whole"[368].

Nevertheless, it is possible for the public benefit test to develop[369], although in the educational context, given the fact that Londsdale[370] was a decision of the Vice Chancellor's Court, it would take a decision of at least the Court of Appeal to do it.

As a result, the Charity Commission stated in its evidence to the Joint Committee that:

> "The existing case law would need to be applied to the modern context in which charities now operate and in light of the new legislation. The exceptions to general public benefit principles… are part of current case law and organisations have been recognised as charities on that basis over significant periods of time. The removal of the presumption of public benefit as proposed by the legislation would probably not change this. The Commission would not be able simply to over-ride these exceptions given that they have been specifically addressed by the court and allowed to stand"[371].

The "wider access" argument

This argument is based, first, on the contention that, pursuant to Re Resch[372], there is an obligation that fees should be moderate, thus facilitating wider access. The trouble with this argument is that Re Resch was a case concerning hospitals and not schools, and the law to date appears clear that the public benefit test is different in respect of each of the four heads of charity. As a result, it is arguable that any principles of wider access in Re Resch are not applicable to independent schools. Furthermore, Re Resch was a Privy Council case and not a decision of the Judicial Committee of the House of Lords, so that, while persuasive, it is not strictly speaking a decision binding on the English Courts. It is unlikely, however, that it would not be followed unless there were significant grounds to distinguish it[373]; although on

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368 Dingle v Turner [1972] AC 601, per Lord Cross.

369 The case that the Commission cites in this regard (Joint Committee Report, DCH 13, Memorandum from the Charity Commission) is the House of Lords case of National Anti-Vivisection Society v IRC [1948] AC 31 at page 42 per Lord Wright; although this again was a decision relating to the fourth head of charity (other purposes beneficial to the community) and not education. The Commission also cites Picarda, The Law and Practice relating to Charities, (3rd Edition) at page 26.

370 See above.

371 Joint Committee Report, paragraph 75, from Ev 192, paragraph 19.

372 See above.

373 Especially since the leading judgement was given by Lord Wilberforce, one of the most respected judges at the time.

the issue of public benefit it might be argued successfully that what comprised public benefit in one society did not necessarily comprise it in another. Re Resch was referred from the Supreme Court of New South Wales.

Secondly, the argument suggests that what comprises "public benefit" evolves and develops from time to time in accordance with what may be viewed by the Courts from time to time as a purpose beneficial to the community. For instance, Tudor states that:

> "In view of the large variety now comprised in the fourth head [i.e. other purposes beneficial to the community], no rigid definition of a section of the community can be given. As Lord Somervill of Harrow said[374]:
>
> > "I cannot accept the principle… that a section of the public sufficient to support a valid trust in one category must as a matter of law be sufficient to support a trust in any other category. I think that difficulties are apt to arise if one seems to consider the class apart from the particular nature of the charitable purpose. They are, in my opinion, interdependent"[375]."

So even within the more flexible fourth head there are different public benefit criteria for different types of charitable purpose. The fourth head is acknowledged to be more flexible in outlook: but there is little to suggest that this flexibility could be carried over to the educational context. Indeed, it is quite likely that, so long as case law prevails in the context of what comprises public benefit, the only way in which the wider access argument will prevail as a strict matter of law, is a judgement over-ruling the Schools Cases handed down by the Court of Appeal or the Judicial Committee of the House of Lords.

This second argument also appeals to a principle that the class of beneficiaries for independent schools is too restricted to make them for the public benefit. This seems unlikely to be sustainable on the basis of the numerous registered charities that provide benefits to the few inhabitants of many tightly defined localities[376].

The concordat between the Charity Commission and the Home Office

This clash was highly unsatisfactory. In consequence, the Joint Committee asked the Charity Commission and the Home Office to unify their thinking about this point; and before the Joint Committee published its report, they wrote to the Joint Committee setting out what they proposed[377]:

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374 IRC v Baddeley [1955] AC 572.

375 Tudor on Charities (9th Edition, 2003) paragraph 2-072.

376 There are further arguments in favour of this "wider access" approach. See, for instance, an informal letter from Christopher McCall QC to the Charity Law Association dated 25 June 2004, which accompanied the Further Memorandum from the Charity Law Association in its evidence to the Joint Committee (DCH 175) Ev. 58.

377 Joint Committee Report, paragraph 78.

"The Commission will apply the broad principles indicated by the Court in the case of Re Resch[378]. These principles are that:

- both direct and indirect benefits to the public or a sufficient section of the public may be taken into account in deciding whether an organisation does, or can, operate for the public benefit

- the fact that charitable facilities or services will be charged for and will be provided mainly to people who can afford to pay the charges does not necessarily mean that the organisation does not operate for the public benefit

- an organisation which wholly excluded poor people from any benefits, direct or indirect, would not be established and operate for the public benefit and therefore would not be a charity."

Other principles to be taken into account in the concordat are:

- the Schools Cases[379]

- the nature of the particular charitable purpose

- the particular circumstances of the organisation

- the current social and economic conditions under which the organisation operates.

The Commission and the Home Office conclude by stating that they see the question of public benefit as evolving over time in the context of social and economic changes in society:

"Finally, we agree that fundamental to all this is the fact that the law on public benefit will evolve and develop over time. This evolution will have regard to both the particular charitable purposes and the social and economic changes in society. It is in this context that the Commission will, in considering the application of the principles which apply to fee-charging charities, including independent schools, be mirroring the court's approach and encouraging the law to develop as appropriate in pace with modern society".

The effect of the Commission/Home Office concordat

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[378] Le Cras v Perpetual Trustee Co Ltd [1967] 3 All ER 915, as above.

[379] See above.

The concordat appears to validate – at least potentially - the charitable status of independent schools so long as they do not wholly exclude those who cannot afford to pay from their benefits. So wider access – quite rightly – becomes a priority. What is not reflected however is the counter-intuitive possibility that the independent schools that are therefore most at risk from the concordat are the ones that are the least "privileged" – the least well-endowed. This is unfair, and must be urgently addressed.

In any event, the concordat does not necessarily reflect the law. At present, the ultimate organisation that can determine and develop the law in this regard is the Courts[380]. Accordingly, adherence to the concordat or any guidance may not create legal certainty for charities, since the Courts will be able to override the principles in the concordat to the extent that they do not reflect applicable law.

The final paragraph exhorting development of the public benefit test in line with the social and economic changes in society appears to give the Commission a wide discretion to "encourage the law to develop as appropriate in pace with modern society". Quite what this will mean in practice is hard to say, but it is possible that the Commission might, in time, seek to make arguments that conferring charitable status on independent schools no longer reflected what society regarded as properly charitable because they were not sufficiently publicly beneficial. It might also mean that the "economic" success of the independent schools sector would render it vulnerable to the removal of charitable status because it was therefore not in the public benefit to confer charitable status on them.

There is also a fundamental tension in the concordat. How can it be said that an organisation that wholly excluded the poor from its services through fees could not be a charity when the Schools Cases must also be taken into account? It seems likely that, since the concordat is built upon Re Resch, the Schools Cases would be subordinated to the approach derived from it.

The concordat itself is therefore a muddle. On one analysis, it attempts to adjust the law without the approval of the Courts. If so, it is a poor and uncertain device upon which to base the public benefit test. The principles of the concordat are largely to be welcomed; but to provide the sector with the certainty it needs in this context any Charity Commission guidance must be based firmly upon applicable law.

Government has latterly stated that the concordat does not comprise a comprehensive statement of the law but amounts to only "a good partial basis" for guidance. Surely, however, the fact and nature of the concordat makes it unlikely that it will not comprise the basis for guidance especially in relation to the application of the public benefit test to fee-charging charities.

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[380] Via the Charity Appeal Tribunal.

Conversely, any guidance – to be reasonable guidance – must seek accurately to reflect the correct legal position.

The Commission, however, published a new paper in January 2005 entitled "Public Benefit – the legal principles". In relation to charities that charge fees the Commission has adopted an approach analogous to that in the concordat.

In "Public Benefit – the legal principles", the Commission states[381] that in considering the extent to which charging by a charity might affect its ability to demonstrate benefit to the public, the following broad principles apply:

- both direct and indirect benefits to the public, or a sufficient section of the public, may be taken into account in deciding whether an organisation is set up and operates for the benefit of the public

- the fact that the charitable facilities or services will be charged for, and will be provided mainly to people who can afford to pay the charges, does not necessarily mean that the organisation is not set up for, and does not operate for the benefit of the public

- an organisation which wholly excluded less well off people from any benefits, direct or indirect, would not be set up and operate for the benefit of the public and therefore would not be a charity.

In applying this approach to cases where high fees are charged for services or facilities provided, the Commission will consider the following[382]:

- does the level at which fees are set have the effect of preventing or deterring the less well-off from accessing the services or facilities?

- If so, can it be shown that the less well off are not wholly excluded from any possible benefits, direct or indirect?

The Commission lists some further factors that may be relevant[383]:

- whether and how the less well off may otherwise access the services concerned, for instance the existence of accessible insurance or other benefit schemes or the provision of wider access to charitable facilities or services

- the nature and extent of the benefit provided

- the nature and extent of any indirect public benefit.

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381 At paragraph 34.

382 Public Benefit – the legal principles, at paragraph 35.

383 At paragraph 36.

In Annex A to "Public Benefit – the legal principles"[384], the Commission makes clear that it relies heavily on Re Resch[385] for its rationale. As discussed above, it is not certain that Re Resch is the correct comprehensive legal basis on which to formulate the public benefit test.

Furthermore, it has been argued that Re Resch is sufficiently incoherent as a decided case so that it would be an inappropriate basis on which to base the concordat or indeed any public benefit test[386]. This paper submits that Re Resch is a coherent case in its own context – i.e. that of sickness and hospitals – and on the basis that it was decided by one of England's most distinguished lawyers at the time, Lord Wilberforce. In that context, it provides an adequate basis for the supposition that: direct and indirect benefits can be taken into account, charges can be made for treatment provided that there is no distribution of profits for private gain, the less well off are not wholly excluded, and the general balance of public benefit is taken into account. As Lord Wilberforce stated[387]: "The test is essentially one of public benefit, and indirect as well as direct benefit enters into account".

Finally, it should be mentioned in this context that it is well settled that gifts for the relief from taxation may comprise a public benefit, and so be charitable[388]. As a result, it seems likely that relief from taxation may be a sufficient indirect public benefit under the principles set out in Re Resch.

How will the Charity Commission apply the public benefit test in practice?

In January 2005 the Commission published another new paper entitled "Public Benefit – the Charity Commission's approach". In this, the Commission sets out the way in which it will apply the public benefit test. In relation to existing charities[389] the Commission concedes that it is still considering the best way of carrying out these checks, but this might include a public benefit section in the annual return that registered charities must submit to the Commission.

The Commission also states[390] that it will develop greater awareness and understanding of the public benefit requirement through the implementation of a four stage process. This four stage process broadly, covers the following:

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384 At paragraph A21.

385 See above.

386 An argument of this nature was put, for instance, by Lord Phillips in the Grand Committee (see Hansard (Lords), 9 February 2005, from column GC110.

387 Re Resch [1967] 3 All ER at page 922 E.

388 See, for instance, AG v Bushby (1857) 24 Beav. 299; see also, Halsbury's Laws of England, Volume 5(2) at page 45, paragraph 40.

389 See paragraph 30.

390 See paragraphs 31 – 41.

- Stage 1 is currently occurring during the Parliamentary progress of the Charities Bill, and entails explaining the public benefit requirement, describing how the Commission intends to develop its work on what public benefit means for different groups of charities, and promoting awareness and understanding about the operation of the public benefit requirement

- Stage 2 will occur after the enactment of the Bill. It will entail reviewing the public benefit papers and issuing draft guidance required by S4 of the Bill. This draft guidance will be the subject of consultation which will last at least three months in line with best practice

- Stage 3 will occur after Stage 2. The Commission will examine particular groups of charities in greater detail and publish information about how in practice a particular group of charities can fulfil the public benefit requirement, and the results of research studies showing the extent to which those charities currently fulfil the public benefit requirement

- Stage 4 will occur after Stage 3, and will consist of the publication by the Commission of its views on the public benefit requirement for particular groups of charities"[391].

The general approach adopted reflects the Commission's evidence to the Joint Committee when it stated that[392]:

> "Once the proposed legislation had been enacted the Commission would look at the position of existing charities, including those registered under a presumption of public benefit where concerns have been raised, or where there is potential for concerns to be raised, about whether they meet public benefit requirements. The Commission would look initially at the fee charging sectors. The Commission would undertake this exercise to ensure itself that these organisations have a public character or, in other words, provide a benefit to the public".

In its evidence to the Joint Committee the Commission explained further how it might go about compiling a regulatory report:

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391 "Public Benefit – the Charity Commission's approach" supersedes a Memorandum published by the Commission in September 2004 entitled "Public Benefit Checks – how we will carry them out". This superseded Memorandum also identified a four stage process for assessing the public benefit of existing charities affected by the presumption: assess how different charities with different charitable purposes believe they meet the public benefit test requirement; for each group of charities covered by the charitable headings in the Bill, contact the main umbrella/representative bodies and ask for their views on how particular groups of charities might show public benefit; carry out research on fee-charging charities; identify areas of best practice and areas of concern and publish the findings in a regulatory report.

392 Joint Committee Report, para 81, from Ev 192, para 27.

> "…We would then fully consult on ways of meeting public benefit within of course the legal framework we have outlined. We would actually take a statistically valid sample entry from that sub-sector and we would assess the extent to which they are meeting public benefits against the criteria we have outlined and consulted on. We will then publish that in the form of a report. We already do regulatory reports of this nature and we would use those results, which of course would have best practice as well as failures to meet standards, as a basis for making the individual assessments, the individual checks, as it were"[393].

"Public Benefit – the Charity Commission's approach" makes clear[394] that the Commission will probably single out fee-charging charities for review because of the balance of risk and public interest and because concerns have already been raised about them[395].

In its evidence to the Joint Committee[396], moreover, the Commission was forthright that it would be likely to commence any public benefit assessments after the abolition of the presumption with the independent schools:

> "Being realistic we are likely to start with fee-charging charities and in all probability schools, but I think as it is something for the Commissioners as a Board to decide, that ultimately they would make that decision".

There are arguments that this approach is problematic:

- The concordat between the Home Office and the Commission, and any subsequent guidance from the Commission, may not reflect the correct legal test to be applied in the educational context[397]. If this is correct, then any attempt to remove an independent school from the register might be capable of appeal to the Charity Appeal Tribunal and thereafter to the High Court and perhaps judicial review

- Any regulatory report published pursuant to this procedure may not reflect the correct legal position

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393 Joint Committee Report, paragraph 82, from Q761.

394 At paragraphs 36 and 37.

395 The Commission's superseded September 2004 public benefit check Memorandum stated that, in relation to public benefit checks of already registered charities, it would start with fee charging charities because the Private Action Public Benefit Review highlighted them as a particular concern. The Commission continued: "We will carry out research exercises on fee charging charities and these exercises will include gathering information on their fee-charging policies and practices. It will also take into account other factors affecting public benefit, such as any measures to widen access to their services and facilities by people who might find taking up their services difficult because of the fees charged. We will also look at how these charities feel they are actually delivering public benefit in practice."

396 Joint Committee Report, paragraph 82, from Q761.

397 See above, and the Schools Cases in particular.

- If loss of charitable status leads to loss of jobs, lifestyle or discrimination for the employees of an independent school, then there might be claims under the Human Rights Act 1998. Whether any such claims would be likely to succeed is open to debate

- Is it reasonable[398], fair or proportionate for fee-paying organisations to be singled out in this way, as it appears that they will?

- Have fee-paying charities received a fair and un-biased hearing in the context of the Bill, and will they receive such a hearing in the context of any future consultation?

- Is it reasonable, fair or proportionate to deprive fee-charging charities of their charitable status as a result of a change in the law when they were properly admitted to the register on the basis of the then applicable law?

- Is it reasonable, fair or proportionate to review some – but not all – of the charities affected by the removal of the presumption? Surely to have a reasonable, fair and proportionate approach all such charities must be reviewed as quickly as possible[399]? This is not what the Commission appears to intend, however, from either from its evidence to the Joint Committee or from its January 2005 publication "Public Benefit – the Charity Commission's approach"[400]. This appears deeply unfair, and will lead to the result that some charities will be allowed to remain on the register without having actively demonstrated public benefit, while others will not. The Commission should be obliged to carry out a thorough and comprehensive review, and not rely upon a problem cases approach.

Should there be a statutory public benefit test?

A statutory public benefit test is superficially attractive, since it might cure some of the uncertainty resulting from the concordat. A statutory test should be avoided, however, for three key reasons:

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398 For instance in the context of "Wednesbury" reasonableness, as subsequently interpreted – see Associated Provincial Picture Houses v Wednesbury Corporation [1948] 1KB 223.

399 The question of the capacity of the Commission to do this effectively is discussed below in Chapter 4 below.

400 As discussed above, in "Public Benefit – the Charity Commission's approach" the Commission states that it will examine particular groups of charities in greater detail (paragraph 36), and that when deciding which groups of charities to look at first it will take account of issues of risk and public interest (paragraph 37). Since concerns have already been raised about educational institutions and hospitals, and other charities that charge fees, it seems inevitable that these will be singled out for review.

- whatever the wording of a statutory test, there would be problems. If the test was sufficiently flexible it would be subject to broad interpretation by the Courts. If it was overly precise, it might emasculate the ability of the test to develop with time to reflect current social and economic circumstances. In either case there might be numerous test cases

- it is right for the Courts, rather than the executive, to be the ultimate guardian of the public benefit test. While the judiciary may not be the ideal barometer of what might comprise public benefit at any point in time, changes in the definition should be made only prudently and cautiously and not in response to every emerging transient social whim. They should also be made in isolation from the executive so that the test is protected from the political imperatives of successive governments from time to time

- regardless of the seeming intransigence of the Schools Cases, what comprises public benefit for educational charities may be capable of change, especially if the concordat becomes accepted as standard practice over time without legal challenge. The retention of the common law public benefit test may therefore comprise the most flexible and confidence-inspiring solution over time.

In any event, notwithstanding the minimum requirements of the public benefit test, it is always open to charities to seek to exceed these minimum requirements as much as possible. To encourage this, Government and the Commission should work with the sector to agree ways for this to happen. Threatening parts of the sector with the loss of charitable status will only lead to defensive behaviour, which will reduce rather than enhance the overall public benefit which those parts are capable of producing. A consensual approach will work best.

This does not however address the question about how the concordat and any derivative Commission guidelines are reconciled with applicable law. The way in which this can be best achieved remains unclear, but this paper believes that a statutory public benefit test is not the correct way to address it for the reasons set out above.

Implications of loss of charitable status

The issues surrounding loss of charitable status are complex, and this paper is not the place to rehearse them in detail. Suffice to say that, if the Commission was to decide that a particular independent school was not a charity for whatever reason, there might be a series of difficulties including:

- the loss of tax exempt status going forward

- the continuing disadvantages of VAT exemption on school fees going forward

- if the Commission believed that the trustees of the organisation in question were applying funds in a way that exceeded their charitable remit or their powers, it might instigate an investigation under S8 of the Charities Act 1993. Depending on the outcome of the investigation, there might be a range of remedies available to the Commission, including taking steps to render the trustees personally liable for breach of trust in respect of any assets that were applied in a non-charitable way; and disqualifying individuals from acting as charity trustees[401]. The Commission might also be able to take advantage of its proposed new power in S21 of the Bill[402] to make an order directing trustees to apply the charity's property as required by the order when the trustees are unwilling to apply the property for the purposes of the charity and it is desirable to make the order for the purpose of securing a proper application of the property for the purposes of the charity

- if the charity was a trust the Commission might be able to apply the funds "cy près" pursuant to S13 of the Charities Act 1993 to such charitable purposes as most nearly matched the purposes of the original gift

- if the charity was a company limited by guarantee then the Commission might decide that a constructive charitable trust had been created, so that, again, the Commission or the Court could require that the monies were applied to such charitable purposes as most nearly matched the purposes of the original gift. This is not certain, however, and it is possible that the company could continue to operate without charitable status[403]

- if it was determined that the school concerned had never been charitable – as happened with the gun clubs when they were removed from the register in the 1990s - then the Inland Revenue might seek to make restitutionary claims for the recovery of reliefs which the school had obtained on the basis of a mistaken understanding that it was a charity[404]

- an independent school that ceased to be charitable might be liable for a capital gains charge on assets at the then full market value and also

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401 Charities Act 1993, S72.

402 Which inserts a new Section 19B into the Charities Act 1993.

403 Charity Commission Publication RR6, Paragraphs 36 and 37 and Annex E.

404 Charity Commission publication RR6 – "Maintenance of an Accurate Register of Charities", Paragraphs 36 to 39 and Annex A.

possibly inheritance tax charges. Clearly, expert tax and accountancy advice would need to be sought about this[405].

It is iniquitous that there is not more certainty in this area. It is equally iniquitous that charities that were deemed to be charitable when they were admitted to the register should be punished when, due to a subsequent change in the law, their charitable status is then revoked, whether prospectively or retrospectively.

The Joint Committee acknowledged this when it recommended[406]:

> "…that the real Bill include provisions to clarify the effect of the loss of charitable status on the assets of a charity. The Government should consider whether the Bill should contain provisions enabling the Charity Commission to agree that trustees in such circumstances can elect to retain their assets and continue to run the organisation, as a not-for-profit organisation without charitable status[407], for the original purposes".

Government rejected this Recommendation in its Reply to the Joint Committee Report[408] on the basis that:

> "The Charity Commission's publication *Maintenance of an Accurate Register* explains the effect of the loss of charitable status under the current law, which we believe provides an adequate basis for determining what happens to the assets of an organisation that ceases to be a charity. We do not in any case believe that changes to the current rules should be contemplated without an extensive public consultation on the matter, since any change could have a significant effect on the rights and expectations of anyone who donates money or other assets to charity".

With respect, this approach does not satisfactorially deal with the issue. It is simply not fair or reasonable to fail to address the legitimate concerns addressed above in the context of the possible loss of charitable status due to a change in the legal environment as a result of the Bill[409].

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405 For instance, S256 of the Taxation of Chargeable Gains Act 1992 provides that, if property held on charitable trusts ceases to be subject to those trusts, the trustees are to be treated as having disposed of the property for a consideration equal to its market value, with any gain on the disposal being treated as not accruing to the charity.

406 Joint Committee Report, paragraph 105.

407 For instance as a new "Community Interest Company" under Part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004, which is due to come into force on 1 July 2005 pursuant to Commencement Order SI 2004 3322.

408 Paragraph 9, at page 7.

409 In any event, even the Charity Commission accepts that the position is not totally clear, especially in respect of charitable companies.

Government should include measures that adopt, as a minimum, the following:

- certainty about the effect of loss of charitable status, whether for a company, a CIO or an unincorporated trust

- certainty about the validity of the concordat and other guidance issued by the Commission with respect to public benefit in the context of applicable law

- where charities fail the public benefit test as a result of the abolition of the presumption, they should be given the option to adjust their practices to fulfil the public benefit test, or to cease to be a charity[410]

- if a charity chooses to cease to be a charity as a result, any resulting tax consequences (other than the loss of future tax reliefs), including any Inland Revenue assertions about possible restitutionary claims for past reliefs, should be mitigated by 100%

- if the Inland Revenue pursues restitutionary claims for past reliefs, then a reimbursement package should be available from other statutory sources so that (other than the loss of future tax reliefs) the effect of de-registration is neutralised.

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[410] This was a position supported by Lord MacGregor in the Grand Committee debates (Hansard (Lords), 3 February 2005, Column GC21). He stated that "I take the case of a school which wants to meet the public benefit test but which is in a rural location where it cannot be accessed by the public generally. It may not be able to offer much assistance with fees because of its financial situation. As I understand it, under the cy près law and under this Bill, that school would have to close. That seems to me unfortunate. Of course no-one would want to use the premises for educational purposes. The sensible answer would be to remove the charitable status but allow the school to continue…".

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