

Charity Regulation Update for England & Wales: Autumn 2012

The summer is often a relatively quiet time for new announcements in the field of charity regulation, but this year a number of major issues have recently emerged which affect issues of charity law and charitable status in England & Wales. We seek to bring these together as we head into the autumn.

Some of these issues can get confused so we felt it helpful to issue a single Kubernesis Bulletin dealing with three separate but inter-related announcements:

- the completion of Lord Hodgson's review of the Charities Act 2006
- the Charity Commission's consultation on new guidance on the "public benefit requirement"
- the likely introduction very soon of the CIO (Charitable Incorporated Organisation) in England & Wales

Please see the end of the Bulletin (p5) for Q&As across all three issues.

All of the issues here are *proposals* for change – but they may mean important changes ahead. Moreover, all these issues come on top of the recent implementation of the Charities Act 2011. We summarise the background to each issue and then give further details.

All issues are specific to charities established under the laws of England & Wales – we have issued other updates from time to time about Scotland and Northern Ireland: please contact us if you want more detail.

The Charities Acts 2006 and 2011

The Charities Act 2011 is now the *main legislation* on charitable status for England and Wales – it was enacted at the end of 2011 and came into force from 14 March 2012. It replaced most of the Charities Acts of 1958, 1993 and 2006. For further details on the 2011 Act, see *Kubernesis Bulletin 2012-01* (now available at www.kubernesis.co.uk/wp-content/uploads/KubBulletin2012-01.pdf.)

So any current references to what charities have to do, notes in charity accounts, reports of auditors and independent examiners, and similar documents should now refer to the Charities Act 2011.

However, Lord Hodgson was appointed to review the *changes* introduced by the Charities Act 2006 – many of which came into effect from 2007 and 2008 – so his report is described as a "Review of the Charities Act 2006" – even though the changes made by the 2006 Act are now in the Charities Act 2011.

The Purpose and Scope of the Hodgson Review (see below on the Recommendations)

The Charities Bill which became the Charities Act 2006 included a relatively unusual provision requiring the Minister to appoint a person to undertake a review of the Act and report to Parliament.

The appointment had to take place within 5 years of the passing of the Act – i.e. by November 2011 – and last autumn the Minister for Civil Society, Nick Hurd MP, appointed Lord Hodgson of Astley Abbots (Robin Hodgson) to undertake the review. Lord Hodgson is a Tory Peer with a keen interest in charities. He was very much involved in the debates in the House of Lords on the Bills which became the Charities Act 2006 and Companies Act 2006, and more recently he has been appointed President of NCVO (National Council for Voluntary Organisations).

Prior to the review of the 2006 Act, Lord Hodgson had previously been appointed by Nick Hurd to undertake a review of "red tape" affecting the voluntary sector, and his report *Unshackling Good Neighbours* appeared in May 2011 – however, that study was more about barriers to volunteering, licensing issues, sale of food, gaming rules rather than matters of charity law.

For his review of the Charities Act 2006, in spring 2012 Lord Hodgson invited people involved in the sector to submit evidence on many aspects of charity regulation (some slightly broader than just those introduced by the Act). He also held workshops in various locations. His work was supported by civil servants from the Cabinet

Office and by the prominent charity lawyer Stephen Lloyd. Gareth Morgan was actively involved in working parties with two major bodies (NCVO and ICAEW) responding to Lord Hodgson's consultation and also had direct communications with him on several issues.

The report of Lord Hodgson's review of the Charities Act 2006 is entitled *Trusted and Independent: Giving charity back to charities* – it was published in late July – available at www.cabinetoffice.gov.uk/sites/default/files/resources/Review-of-the-Charities-Act-2006.pdf

The report makes a long list of 113 recommendations – some to the Charity Commission, some to the sector, and some issues for consideration by Ministers which would need changes to legislation. Some are somewhat controversial – see our comments below.

However, none of the points he recommends will *necessarily* lead to change – it is up to Ministers, the Charity Commission and others to decide what action to take.

As regards next steps, Nick Hurd MP has written to a wide range of umbrella bodies in the charity sector saying that he would be “grateful for their views” on next steps. In particular, he has asked people to indicate those recommendations which are seen as priorities for action.

Charitable Incorporated Organisations – Implementation now expected Oct 2012

Readers of Kubernews updates will be aware that we have long been enthusiastic for the new legal structure of a Charitable Incorporated Organisation (CIO) which was enacted in the Charities Act 2006.

A charity which is structured as a CIO is a corporate body with limited liability but registered solely under charity law – it is *not* a company and does not register with Companies House.

However, various detailed regulations for CIOs had to be laid before Parliament, and even though there was a detailed consultation back in autumn 2008 on drafts of the regulations, for various reasons the final regulations have been subject to huge delays.

Scottish CIOs – known as SCIOs – have, however, been available since April 2011 and are proving popular. Figures from the Scottish Charity Regulator, OSCR, show that more than a quarter of new charity registration applications in Scotland are for SCIOs.

The SCIO is a good form, we believe, for charities working UK-wide: earlier this year we established a SCIO for a Kubernews client. But to be a SCIO a charity needs at least one trustee or an office in Scotland in order to provide a “Principal Office”. So, for charities working locally in England (or Wales) it has been necessary to wait for implementation of the English CIOs – which are now governed by the Charities Act 2011.

Finally, it seems the regulations for CIOs will actually be tabled in Parliament this autumn. There has to be a vote, but barring any major objection (which seems very unlikely) they are expected to become fully operational within a few weeks and the Charity Commission will then accept applications for registration of CIOs.

Of course *we cannot be certain* until the regulations are actually tabled in Parliament (following the summer recess) and passed, but we are much more optimistic than before for three reasons:

- Lord Hodgson in his report *Trusted and Independent* (see above) is very critical of the delays, but he has clearly been given assurances that the introduction of CIOs this autumn is more or less definite. He says: “The key concern on CIOs is, unsurprisingly, that they have not yet been implemented. Implementation of the CIO has been long-awaited by the sector; it was originally scheduled for 2009 but has been severely delayed. This delay has been a great disappointment to charities and to the professional advisers who work with them.” But he adds: “However, the secondary legislation that will create CIOs will soon be laid before Parliament and, pending Parliamentary approval, should be operational by the autumn. This is very welcome progress, if not before time.”
- In May 2012, the Cabinet Office issued a “one year on” report in relation to Lord Hodgson's previous report *Unshackling Good Neighbours* (see above) which said on CIOs: “The Office of Civil Society is now taking forward the various clearances required before the statutory instruments can be laid in Parliament and the new form of charity should become available during October.”
- The Charity Commission (CC), too, seems to regard this as definite. Their website FAQs say: “Can I register a Charitable Incorporated Organisation (CIO)? Answer: No, at the moment you are not able to register as a Charitable Incorporated Organisation (CIO) because this new legal structure is not available until October 2012.” However, the CC published their own detailed guidance on CIOs back in April 2011.

Those who want to wait until everything is certain will, of course, have to wait until the regulations are actually passed by Parliament, but we feel there is now sufficient confidence that those wishing to establish CIOs in the near future can meaningfully start drawing up constitutions.

We are thus working closely with clients wishing to convert existing unincorporated charities to CIOs or for completely new charities keen to form as CIOs.

Charity Commission Publishes New Draft Public Benefit Guidance

One of the central features of the Charities Act 2006 – now in the Charities Act 2011 – was a renewed focus on the *public benefit requirement*.

This is a requirement – which has been part of case law for centuries – that an organisation cannot be a charity unless it is established for purposes which are “for the public benefit”.

This has led to massive debate in recent years – some of it very confused¹. Some people have suggested that the Charity Commission is using the public benefit requirement to “get at” certain charities – others feel that the requirement is too vague and that charities are being “let off the hook”.

Many people think that the Charities Act 2006 introduced, or radically changed, the public benefit requirement, but it actually only made very slight changes:

- it removed the so-called “presumption” of public benefit under which some charities were “presumed” to meet the requirement – so all charities have to be explicit about this
- it created new objectives for the Charity Commission, one of which is ‘to promote awareness and understanding of the operation of the public benefit requirement’
- it required the Commission to issue guidance in pursuit of its public benefit objective and to revise the guidance from time to time – moreover all charity trustees are required to ‘have regard’ to the guidance
- regulations under the Act introduced the requirement for ‘public benefit reporting’ – so, for all registered charities, the trustees’ annual report issued with the accounts must explain the activities undertaken to further the charity’s purposes for public benefit – and to say whether the trustees have had regard to the Charity Commission’s guidance.

The Charity Commission produced its initial guidance on public benefit in 2008. It comprised five booklets

- *Charities and public benefit: The Charity Commission’s general guidance on public benefit* (ref PB1)
- *The prevention or relief of poverty for public benefit* (ref PB2)
- *The advancement of education for the public benefit* (ref PB3)
- *The advancement of religion for the public benefit* (ref PB4)
- *Public benefit and fee charging* (ref PB5).

However, many people said they found the guidance hard to use, and the Charity Commission (CC) had always said it would be revised in due course. In particular, two major Tribunal cases in 2011 have clarified the legal interpretation of public benefit. The first of these, brought by the *Independent Schools Council* has led to clarification of the principles around when charities can charge fees for their services, particularly in the education field. The second case has clarified the rules for *Benevolent Funds* – i.e. charities for the relief of poverty where the beneficiaries are restricted by particular links of employment, family, or membership of an organisation.

The New Draft Guidance

Initially the CC re-issued some of the 2008 guidance with sections deleted, but it has now published in draft a completely new set of proposed guidance and it is seeking comments. For details see: <http://publicbenefitconsultation.blogspot.co.uk/>

The new draft guidance is not issued as a normal printed document, but is divided into many separate sections for use online, and they are inviting comments through an online blog as above (although if you find this inconvenient – as we did – you can ask for a copy of the full guidance in a Word document. They are inviting comments up to 26 September.

Our Initial Response

Our initial thoughts are that the new guidance is generally clearer than what was issued in 2008, and the CC have done a better job of distinguishing between what is legally required as opposed to general good practice.

However, we are not at all keen on the new format – if trustees are required by law to ‘have regard’ to the guidance it needs to be available in a booklet or PDF so it can conveniently be read in full.

We feel, however, there is still a good deal of confusion between activities and purposes. In law, the test of charitable status is based on the *purposes* of an organisation – if a charity carries out activities which are inconsistent with its purposes the trustees may be committing a breach of trust (which has serious consequences) but it doesn’t mean that the organisation isn’t a charity!

¹ For a detailed history of the debate, see Gareth Morgan’s paper “Public benefit and charitable status: assessing a 20-year process of reforming the primary legal framework for voluntary activity in the UK” (arising from his academic work) which recently appeared in the research journal *Voluntary Sector Review* 3(1) 2012 pp 67-91.

The draft guidance also seems to suggest it is common for charities to be set up with misleading governing documents where the written charitable objects don't reflect the true purposes and hence the CC needs to look at the activities to discover the true purposes – but we feel this is extremely rare.

The new draft guidance also includes a great deal on the Equality Act 2010 (which is new since the 2008 guidance). A charity can only have purposes which focus on people with specific protected characteristics under the Equality Act (gender, race, age, religion, sexual orientation etc) if the charity meets specific exemptions in the Equality Act. However, we are concerned that the Equality Act issues are somewhat over-emphasised – we feel that most charities involved in specialist work with particular groups – such as young people's groups, women's refuges, disability charities, and charities working within specific religious faiths – will readily meet the exemptions in the Equality Act. In any case, the Equality Act is just one statute amongst hundreds which can affect charitable work: plenty of other legislation is relevant.

Action

If you have any views on these issues – whether about the format or content of the guidance – we would recommend logging on the CC's Blogspot website as above and submitting some comments. We believe the CC are genuinely keen to take account of views submitted. The deadline is 26 September 2012.

The Hodgson Review of the Charities Act 2006 - Recommendations

As mentioned above, Lord Hodgson's review of the Charities Act 2006 contains 131 recommendations. Most of them make excellent sense and are relatively uncontroversial. We have selected a few of his recommendations which touch on areas where we are frequently asked for advice, and offer some observations on his proposals.

Organisational forms – CIOs, IPSs etc

As noted above, Lord Hodgson seems to take it as definite that CIOs will finally be implemented in autumn 2012, so he does *not* present this as a recommendation. However, he sensibly recommends that there is *no need for a special charges register* for CIOs – as with other borrowers, details of mortgages etc will be available via the Land Registry and in the charity's accounts. His only new recommendation (which makes sense) is that there should be a review of CIOs three years after their implementation.

However, for Industrial and Provident Societies (IPSs) – a legal form which is used by some charities, currently exempt from registration with the CC, he recommends that they should be required “either to register with the Charity Commission or to resign their charitable status”. We feel this makes sense. The Charities Act 2006 (now in the 2011 Act) allows for IPSs to lose their exempt status and have to register, but for those which cannot make the criteria an option to “resign” their charitable status is a helpful suggestion.

Excepted charities – e.g. churches

At present, many charities which were formerly not required to register as charities are still excepted from registration – this applies especially in the church sector. Although the Charities Act 2006 created a framework for formerly excepted charities to start registering it only applies to those over £100,000 income (though the Minister can reduce this threshold). Lord Hodgson agrees it is right to move forward on this. He says: “It is my view that the process for lowering the registration threshold for what are currently excepted charities should continue until it matches the general compulsory registration threshold [currently £5000]. The existence of the current exception adds confusion and complexity to the charity sector landscape and has long outlasted its original justification. The wider interests of transparency, accountability and equal treatment across the sector as a whole must also be considered; it is important that those who support charities are able to understand the structure of the sector and are equipped with the information to enable them to exercise their judgment in relation to it.”

Smaller charities – filing accounts

Lord Hodgson considers that the requirement to file accounts with the CC should be extended to all compulsorily registered charities – i.e. all *except* those which are on the register voluntarily (in general, voluntary registration only applies to very small charities under £5000 income although he suggests this could be increased). We support this proposal – it seems absurd at present that an organisation has to jump enormous hurdles to be registered as a charity, but then if its income is under £25,000 there is no requirement to file accounts – except for CIOs. (However, he proposes that all such accounts would have to be filed electronically – i.e. as a PDF. So, a treasurer preparing accounts manually would have to get them scanned, once approved by the trustees, in order to submit as a PDF.)

Audit/independent examination threshold

Lord Hodgson does not recommend any substantive changes to the accounting thresholds in the 2011 Act except on one key issue: he recommends that the upper limit at which a charity can have an independent examination of its accounts (rather than being forced to have a full audit) should be increased from £500,000 income to £1M. He also recommends removing the complex assets test under which some charities with incomes under the threshold still need an audit if they have over £3.26M assets. This, too, we feel makes excellent sense.

Trustee remuneration

Some of Lord Hodgson's recommendations are split between what he describes as "small charities" (up to £25,000 income, which he suggests as a new threshold for compulsory registration – with voluntary registration below this), "medium charities" (up to £1M income) and "large charities" above this. In the case of large charities he suggests it should be possible to pay trustees for their services if the charity so decides *without* needing explicit permission from the CC. This is one of the more controversial proposals: several major bodies in the sector have written to Nick Hurd urging him *not* to implement this on the grounds that it would fundamentally undermine the principle of voluntary trusteeship and would impact on charities of all sizes.

Sanctions

Whilst he does not make a firm recommendation, Lord Hodgson encourages Government and the CC to give serious consideration to a system of fines for charities which do not file accounts on time. He is also keen to see charities whose accounts are in arrears suspended from claiming tax back on gift aid donations.

Charging charities for regulation

One of the most sensitive issues is whether charities should in some way contribute to the costs of the Charity Commission's work. He expresses concern at the declining resources available to the CC and argues that whilst some efficiencies are possible, the CC must be properly resourced. He concludes that it would not be unreasonable to have modest charges for charity registration and for filing annual returns. But he stresses that this must not allow the Government to reduce its own support for the CC – he reminds readers that "Successive Governments have placed great emphasis on the need for a large and diverse charity sector".

Questions and Answers – What Does it all Mean?

Q1: Does any of this have an immediate impact on my charity?

A1: Everything reported in this Bulletin is just a *proposal* so there is no *immediate* impact – but we encourage charities to be aware of what is proposed in order to be ready for possible changes – and to feed in comments to consultations where you see concerns or difficulties.

Q2: Will the proposals alter the definition of what can be a charity?

A2: No, there is no proposal to change the fundamental definition in the Charities Act 2011 – a charity in England & Wales is an organisation established for exclusively charitable purposes and those purposes must be for the public benefit. However, it is important to appreciate that the "public benefit" requirement is mainly derived from case law, so the Charity Commission's new public benefit guidance will be very important in practice in terms of the "boundaries" around what is seen as charitable.

Q3: Will CIOs be different in terms of charitable status?

A3: The definition of charity (see Q2 above) will apply to CIOs in the same way as all other charities. But a CIO can only be created if it meets the charity definition, and moreover every CIO will be a registered charity (there will be no exempt or excepted CIO charities). So when people apply to the Charity Commission to register a new CIO, the CC will refuse registration if they consider it does not meet the charity definition – in particular the public benefit requirement.

FURTHER HELP: The Kubernesis Partnership LLP offers a range of seminars on issues concerning charity regulation and accounting. See www.kubernesis.co.uk/seminars.

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- If you are not currently in KCAS it is possible to register online (see www.kubernesis.co.uk/advice-service) and then queries can be raised immediately subject to the terms of the scheme. For other enquires, please e-mail info@kubernesis.co.uk.

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