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charitiesalert

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Issue 9

Charities Alert - A HPH newsletter for organisations with charitable status

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Unclaimed assets consultation

In May The Office of the Third Sector and the Treasury published a consultation on the government's proposed framework for distribution of unclaimed assets, primarily dormant bank accounts. Unclaimed assets are defined as those in accounts which have not had any 'customer-initiated' activity for a period of at least 15 years, and the consultation makes it clear that, even once the distribution scheme is active, customers will still be able to reclaim their own assets at any time.

The consultation calls for a fair distribution of assets across the four countries of the United Kingdom, but notes that the focus of distribution in each territory will be determined by the devolved governments of the separate countries. The distribution in England is intended to focus on youth services and financial capabilities and inclusion.

The consultation sets out the key principles for distribution; proposals for distributing assets on a UK-wide basis, and specific comment on the proposed focus of distribution in England; the legislative changes which would be necessary to implement the scheme and the specific questions for consultation.

The full text of the consultation can be accessed on the Treasury website www.hm-treasury.gov.uk

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Payroll giving

Oxfam has launched the 'Oxfam at Work' initiative to attempt to raise the profile of payroll giving. As a result of the reduction in the basic rate of income tax from April 2008, the additional money that charities receive through Gift Aid on after-tax donations will be reduced by 11% and Oxfam is one of many fundraising charities which are looking at ways to make up the shortfall. Payroll giving, as a pre-tax donation, is potentially a more tax-efficient way for workers to make charitable donations as they will benefit from higher-rate and basic-rate deductions in tax – so for a £10 net donation, a charity would receive £16.67 under payroll giving; as opposed to £12.82 under Gift Aid as it stands, or £12.50 from April 2008.

Charities Act 2006 – what Trustees need to know

The Cabinet Office and the Charity Commission have jointly published a 'plain English' guide to the Charities Act 2006, which sets out the key issues and changes that Trustees will need to be aware of. The guide is aimed primarily at Trustees of charities below the new audit threshold of £500,000 annual income, but may be of interest to Trustees of larger charities as well.

The guide is available from:
http://www.cabinetoffice.gov.uk/third_sector/law_and_regulation/charities_act_2006/

Charities Act 2006 – further implementation developments
In May the Office of the Third Sector launched a consultation on the third phase of the Act's implementation, the first phase having focused on the Charity Commission's status and powers and implemented the new registration and audit thresholds for all non-exempt charities, while the second phase brings the Mergers Register into being from 1 October 2007 and modifies the regulation of fundraising and of charitable companies' constitutional changes. This third phase mainly consists of changes to the charity accounting and reporting regimes under the Charities Act 2006 and the Companies Act 2006. The audit threshold under both Acts has already been increased by the First Commencement Order, which took effect for accounting periods commencing on or after 27 February 2007, and the current consultation considers the following further areas: harmonisation of audit and independent examination requirements to put incorporated charities on a par with unincorporated charities (ie, total exemption available only below £10,000 gross income); providing a statutory framework under the *Charities Act 1993* for group accounts and annual reports where the audit threshold is exceeded and the parent entity is either a charitable company or an unincorporated charity; providing clearer whistle blowing duties and protections for auditors and independent examiners of unincorporated charities and imposing the same regime on those of charitable companies as well; and the use of Trustees' annual reports for reporting on public benefit.

The proposals are expected to be implemented for accounting periods beginning on or after 1 January 2008. In particular, the proposal to require group accounts above the new audit threshold of £500,000 gross income (as distinct from the turnover threshold used in the Companies Act definitions) and the proposed threshold reduction from £90,000 to £10,000 gross income for charitable company independent examination will be of special interest for those involved with smaller charities, where the consultation asks for comment on whether these thresholds are appropriate or how they might be changed – clearly an opportunity for further deregulatory measures if there is enough popular support for them.

The full text of the consultations can be found at:
http://www.cabinetoffice.gov.uk/third_sector/law_and_regulation/charities_act_2006/implementation.asp

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Current consultations
There are two new consultation documents of interest to charities. The Ministry of Justice has launched a public consultation on its draft rules for the Charity Tribunal, which is expected to be in operation from early 2008 as part of the Third commencement Order under the Charities Act 2006. Apart from the lack of any transitional provision for cases where a final decision of the Charity Commission has gone unchallenged in recent years in face of the prohibitively high costs of appeals direct to the High Court (to remedy which the Charity Tribunal is being set up), the proposed rules appear to be unexceptionable.

The Charity Commission has launched a public consultation on its revised Directions for the Independent Examination of charity accounts, following changes to reporting and assurance requirements under the Charities and Companies Acts of 2006. The key change to the Independent Examination regime is its extension to cover charitable companies claiming audit exemption,

thus providing a single independent review regime for charities whose accounts are not required to be audited.

This change fails to take advantage of the obvious deregulatory opportunity that presents itself under current government policy to set the total exemption ceiling not at £10,000 gross income, the existing level for *non-company* charities, but at the £90,000 level set for charitable companies under the 1985 Companies Act regime. However, it now seems that a further public consultation is to be launched this autumn on proposals based on the results for the government's recent review of all the regulatory thresholds, including this one. For now, it is worth noting that by rounding that £10,000 up to £100,000, in line with the present accruals accounting threshold for non-company charities, some 45,000 of them could be freed from the regulatory burden of having to obtain independent scrutiny of their accounts, which even in aggregate are immaterial to the public interest, as they amount to less than 4% of the total gross income of all registered charities.

Responses to these consultations are requested by 7 and 16 November 2007 respectively, and the consultation documents can be found at:
http://www.justice.gov.uk/publications/cp1907.htm (Charity Tribunal) and
http://www.charitycommission.gov.uk/enhancingcharities/cc63consintro.asp
(Independent Examinations).

Guidestar developments
The Guidestar UK public access database has some new analysis features which will allow for charities to be judged more easily against their peers in terms of their financial performance. In particular, levels of reserves, liquidity ratios and fundraising cost ratios are likely contenders for benchmarking charities. It remains to be seen how sophisticated these tools are, and in particular how well the implications of the raw data are explained, put into context and understood by users.

More information on Guidestar's services can be found at:
http://www.guidestar.org.uk/

OSCR publishes pilot report
On 18 July, the Office of the Scottish Charity Regulator (OSCR) published a report on the pilot of the charity test Rolling Reviews which it will be carrying out from September 2007. The report reiterates the requirements of the Charity Test under Scottish charity legislation and sets out detailed findings for each of the eight Scottish charities which volunteered to take part in the pilot, including consideration of their charitable purposes, the way in which they provide public benefit and the effects of any conditions or limitations on access to benefit. The charities which failed the test were those whose constitutions provided for political influence (ie, by government ministers) or else for the distributions of funds for non-charitable purposes. Concerns were also raised over activities carried out which were not strictly in accordance with the given charitable purposes of one of the participating charities. It is interesting to note that none of the fee-charging charities were deemed to have failed the test on this basis, although the Scottish test is much more explicit with regard to public benefit and the reasonableness or otherwise of fees charged for services. As noted in a previous Alert, this pilot may well influence the application of the Public Benefit requirement in England and Wales under the 2006 Act.

The report is available in pdf format from OSCR's website as follows:
http://oscr2005phase2.cctechnology.com/GuidancePublicationItem.aspx?ID=790454db-c467-4fa0-af8e-4fbc08c3450a

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Protecting Charities from Terrorist abuse – a Home Office / HM Treasury consultation seeks to add further safeguards to those imposed by the Commission's 2007 Annual Return Regulations
An exceptional 'special-interest' public consultation on the charity sector's regulatory regime has just ended. This forms part of the wider implementation of an 'NPO Code of Conduct' issued by the EU last year for all Member States to apply to their own voluntary sector over a three year period, using a combination of state regulation and self-regulation wherever possible. The measures now proposed by government address the need to strengthen the sector's defences against any possible misuse of 'high-risk' charities by terrorist organisations bent on using them to finance their own activities. This is to be achieved by making the Charity Commission more proactive as a liaison link between the national security/intelligence services and all the 'high-risk' charities, and so providing suitable advice and guidance to the latter. The charities themselves would be required to assess their own risk in this area as an aspect of 'good governance', and to mitigate it by adopting anti-money-laundering protocols like those established in the financial services and business sectors: a 'know your beneficiary/donor' principle requiring the charity to identify and forestall any possible funding connections either to designated terrorist organisations (such as those on the Bank of England's asset-freeze list) or to anyone else suspected to have connections with them.

What is noteworthy here is that all registered charities above a threshold £25,000 gross income are already expected to have such precautions in place. This can be seen from the new Part B introduced in the Charity Commission Annual Return for 2007 year-ends. AR07 – Part B imposes a new 'whistle blowing' duty to make a 'Serious Incident Report' direct to the Charity Commission each time if the charity trustees fail to verify the source of a major donation, or if their charity suffers a significant* loss of money or other resources (*£25,000 or 20% of total income, if less) or if any link is suspected between a proscribed organisation and the charity or its trustees/staff. It is hard to see how the consultation's proposals can improve on such a demanding obligation.

VAT matters

Charity Pensions – A VAT Bonanza?
Most charities run their own pension schemes. This may be of interest to trustees and administrators of such charity pension schemes.

You may have seen the recent European Courts of Justice (ECJ) decision in respect of J P Morgan Fleming Claverhouse Investment Trust plc v HM Revenue & Customs (HMRC). The decision extends the VAT exemption on fund manager's charges to now cover Investment Trust Companies (ITCs).

UK VAT law must follow the principles of European VAT law. Article 13B(d)(6) of the Sixth Directive requires exemption for management fees of 'special investment funds'. UK and other European Governments have some discretion

to determine what constitutes such funds. The UK limits the exemption only to Open Ended Investment Companies and Authorised Unit Trust schemes.

J P Morgan argued that although ITCs were closed rather than open, these still represented the 'special investment funds' as defined by EU Law. The ECJ held that the words 'special investment fund' could include closed ended investment funds such as ITCs, as there was relatively little difference between the two types of scheme and thus they were 'in competition'. The decision relied heavily on the fact that the UK's stance went against fiscal neutrality.

This decision may represent an opportunity for pension schemes, but in the view of legal commentators, it seems to ask more questions than it answers. Firstly, can pension schemes be seen in the same light as ITCs?

If they can, and as the VAT exemption for fund management services now seems largely to depend upon whether there is competition between fund managers applying different VAT rates, it is now necessary to confirm whether such competition exists in this sector.

One advantage to pension schemes is that it is for the fund managers to determine whether their own supplies now fall within the VAT exemption. Pension schemes who consider that they may now have been overcharged VAT will only need to consult their funds managers and will not have to deal directly with HMRC.

We suggest that you should:

- Quantify the amount of irrecoverable VAT at stake
- Determine how your fund mangers are reacting to this decision

You should be enquiring with your fund managers that they have submitted such claims to HM Revenue & Customs (HMRC) and find out when they expect to repay the overcharged VAT. There is currently a three year limit on claims, although this is being challenged at the moment. As the three year limit remains for now, and as it is the managers making the claims, pension schemes need to ensure that all their investment managers have already made claims for the three year period, or will make a claim as a matter of urgency. This will ensure that no further VAT quarters become out-of-time before this issue is finally resolved, especially as this may well take some time.

Many investment managers have made claims and, as far as we are aware, to date all such claims have been rejected by HMRC. This is likely to be the case because the ECJ decision raised more questions than answers in some respects, and the National Association of Pension Funds (NAPF) is looking to take a lead case to try and remove the biggest question mark which is: what is the definition of 'in competition'?

The JP Morgan decision ruled that the UK interpretation of what are VAT exempt investment manager services was too restrictive, but in order to change the VAT liability, the fund managers currently charging VAT must be 'in competition' with those fund managers who are involved in services HMRC already accept as exempt, such as Unit Trust companies and OEICs.

Therefore, your priority must be to ensure that your investment managers have made the relevant protective claims, so as to ensure that you do not ultimately lose out should the decision eventually go for pension schemes.

Claims for VAT on Charity Investments Costs
Many of you will have already taken advantage of the ruling in the Church of England Children's Society case (High Court decision dated 29 July 2005), which forced HMRC to revise its position on the recovery of costs relating to obtaining non-business income, in respect of donations in particular.

As you are probably aware, the liability of the income is no longer relevant to the recovery of such costs. The key now is what the money is spent on. If the money is used wholly for non-business purposes, the VAT cost remains irrecoverable. However, if the use of the funds is unrestricted, and there is some taxable business use, then a related proportion of the investment costs can be reclaimed.

We have however found that a number of our clients have not applied the new treatment to their own investments costs. Income derived from investments is also seen to be non-business. Where VAT costs are incurred on investments, and the money generated is unrestricted, the same residual recovery applies.

Fundraising code of practice
The Institute of Fundraising has published a revised code of practice dealing with Legacy fundraising. The key messages of the revised code are the need for honesty, openness and confidentiality in soliciting legacy gifts. In particular, the code deals with the issues of influence and incentives in fundraising, especially with regard to meetings with potential legators.

The full text of the code can be found at: http://www.institute-of-fundraising.org.uk/bestpractice/thecodes/codesoffundraisingpractice/codesdirectory/

Companies Act changes affecting charities
From 1 October 2007, the Companies Act 2006 (the Act) will require a director to declare to the other directors the nature and (additionally to the current law) the extent of his or her interest in transactions and arrangements entered into by the company, although there will be no need to disclose where the matter cannot reasonably be regarded as giving rise to a conflict or where the directors know or ought reasonably to know about it.

This duty to declare is divided into:

- The duty to declare his/her interests in transactions or arrangements that are proposed but have not yet been entered into by the company [s.177]; and
- The duty to declare his/her interests in relation to existing transactions or arrangements that the company has already entered into [s. 182].

Declarations may be made at a board meeting, by written notice or by general notice (effectively 'deemed' notice), and must be made as soon as is reasonably practicable.

s.183 of the Act, which is anticipated to take effect from 1 October 2008, makes a criminal offence of a director's failure to declare any such interest. This implies a duty to be aware of all the transactions and arrangements entered into by the company or else to put the company on 'general notice' by making a personal declaration to the Board listing all the director's connected persons and legal bodies (companies, etc). This duty seems to catch not only conflicts of *personal* interests, where (for a charity) unauthorised 'trustee-benefits' are prohibited in any case, but also any potential 'conflicts of loyalties', such as being on the board of both charities contracting with each other in the normal course of business.

For best practice in charity governance, as encouraged by the Charity Commission, this might be an opportune moment to review existing policy and practice on managing any conflicts of interest (of both kinds) – if only to avoid the embarrassment of inadvertently breaching s. 183.

For any queries, comments, suggestions for future articles, or if you would like to receive this newsletter via email please send an email to Robert Woolley at robert.woolley@hphonline.co.uk

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