Law Commission
Reforming the law

Technical Issues in Charity Law

Summary

Consultation Paper No 220 (Summary)

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THE LAW COMMISSION

TECHNICAL ISSUES IN CHARITY LAW

SUMMARY

INTRODUCTION

1. Charities occupy a special place in society and in law. The law protects and regulates them. Our project is intended to further these objectives by removing unnecessary regulation while safeguarding the public interest in ensuring that charities are properly run. Charities currently face unnecessary administrative and financial burdens because of inefficient and unduly complex law. We make provisional proposals for reform to overcome these burdens and we invite consultees to share with us their views on our proposals.

2. In 2011 the Law Commission decided to undertake a project on technical issues in charity law comprising: (1) an examination of issues arising from Lord Hodgson's review of the Charities Act 2006; and (2) a review of the procedures by which charities governed by Royal Charter and by Act of Parliament amend their governing documents. Lord Hodgson's report, published in July 2012, identified several technical legal problems faced by charities. We included many of them within the terms of reference for the project.

3. Between April and June 2014 we consulted on social investment by charities and in September 2014 we published our final recommendations.[1]

4. We are now consulting on the remainder of the project, which comprises a collection of discrete technical legal issues. Some consultees may wish to respond to the entire consultation paper; others may have an interest in just one area. The consultation paper is divided into 8 parts, comprising 17 chapters. This summary is intended to provide an overview of the issues raised in each chapter of the consultation paper, in order to help consultees to find their way through the paper and identify the proposals and questions that are of interest to them.

CHANGING PURPOSES, AMENDING GOVERNING DOCUMENTS AND APPLYING PROPERTY CY-PRÈS (PART 2)

5. Charities can take several different legal forms. A charity may be incorporated, which means that it has a legal personality separate from its trustees and members (if any). Incorporated charities include charitable companies, charitable incorporated organisations (CIOs), charities incorporated by Royal Charter and charities incorporated by Act of Parliament. An unincorporated charity has no separate legal personality and will be structured either as a trust or as an unincorporated association.

6. All charities, whatever their legal form, have a governing document, which is the rulebook for the charity: it sets out the purposes for which the charity is established,

[1] Social Investment by Charities (2014) Law Commission Consultation Paper No 216; Social Investment by Charities: The Law Commission's Recommendations (September 2014), available to download from the Law Commission's website (A-Z of Projects > Charity Law).

the powers and duties of its trustees and rules relating to internal governance, for example rules on appointing and removing trustees. In Chapter 2 we explain that a charity may need to amend its governing document for a variety of reasons, which can range from minor technical changes to fundamental changes to the way the charity is run or the charitable purposes that it pursues. It is important that changes can be made as quickly and efficiently as possible, whilst retaining safeguards to ensure that any amendments are in the best interests of the charity and its beneficiaries. In Chapter 3 we discuss the current law that governs how charities can amend their governing documents. The amendment procedures available to a charity depend on its legal form: the Charities Act 2011 treats incorporated charities differently from unincorporated charities, and charities governed by Royal Charter and by Act of Parliament are subject to special regimes.

7. In Chapter 4 we focus on the position of charities governed by Act of Parliament ("statutory charities") and by Royal Charter ("Royal Charter charities"). The procedures that these charities must follow to amend their governing documents are said to be long, bureaucratic and expensive despite the careful assistance provided by the Privy Council Office, the Cabinet Office and the Charity Commission.

    (1) Statutory charities must ask the Charity Commission to draft a "scheme" to be approved by Parliament under section 73 of the Charities Act 2011 ("the 2011 Act"), a process that can take several years.

    (2) Royal Charter charities must ask the Privy Council to approve amendments or to grant a supplemental Charter; the processes can take a year or more and can be expensive for the charity, particularly if the amendment is by way of a supplemental Charter that must be printed on vellum.

8. The requirement for Parliamentary and Privy Council oversight is the same, regardless of the substance of the proposed amendment; a change to the charity's objects must follow the same procedure as a change to the number of trustees if the provisions governing those matters are contained in the same document. Our view is that minor amendments should not require Parliamentary or Privy Council oversight. We provisionally propose that statutory charities and Royal Charter charities be given a power to make minor amendments to their governing documents without needing the prior consent of Parliament and the Privy Council, and we ask consultees how such a power should operate. Additionally, in respect of Royal Charter charities, we provisionally propose that a charity's Charter should be deemed to include a power of amendment that is exercisable with the consent of the Privy Council, so that supplemental Charters – and the associated costs of printing on vellum – cease to be necessary. We also ask consultees whether guidance from the Privy Council would be a helpful measure to assist Royal Charter charities when they amend their governing documents.

9. The existing procedures involving Parliamentary and Privy Council oversight would continue to apply to more significant amendments. We ask consultees whether and how those procedures could be improved. We suggest that the new power to make minor amendments should not apply to Parochial Church Councils and we ask consultees how, if at all, the new power should apply to higher education institutions which are governed by Royal Charter, by the Education Reform Act 1988 or by their own Act of Parliament.

10. We then turn to other legal forms of charities: charitable companies, CIOs, trusts, and unincorporated associations. In Chapter 5 we examine charities' power to change their purposes. We conclude that the power for incorporated charities to change their purposes is satisfactory. Unincorporated charities with an annual income of £10,000 or less that do not hold "designated land"[2] have a statutory power to change their purposes under section 275 of the 2011 Act, subject to the power of the Charity Commission to object. We provisionally propose that the power be extended to unincorporated charities with higher annual incomes and which hold designated land. We also ask consultees whether the Charity Commission should continue to be able to object to charities exercising the power.

11. In Chapter 6 we consider charities' power to amend other provisions in their governing documents. We conclude, again, that the powers of incorporated charities are satisfactory. We highlight difficulties with the statutory power of unincorporated charities to amend the administrative provisions of their governing documents under section 280 of the 2011 Act and we ask consultees whether the power is helpful and sufficiently clear.

12. Chapter 7 concerns the situation where too much or too little is raised for a fundraising appeal. Where too much is raised, the Charity Commission can direct that the surplus is applied cy-près.[3] But when too little is raised, the trustees will usually have to attempt to contact the donors to offer them a refund before the funds can be applied cy-près.[4] Our provisional view is that this is appropriate, but we ask consultees whether the requirement should be removed in respect of small funds and small donations, thereby permitting the Charity Commission to make a cy-près scheme without the charity first having to attempt to locate the donors and offer them a refund. We also ask whether the trustees themselves should have a power to apply small funds and small donations cy-près without involving the Charity Commission. Finally we ask whether other improvements could be made to the existing regime.

REGULATING CHARITY LAND TRANSACTIONS AND THE USE OF PERMANENT ENDOWMENT (PART 3)

13. Chapter 8 concerns charity land. Charities are subject to restrictions when they sell, let or mortgage their land (but not when they acquire land).

    (1) If selling land, or granting a lease for more than seven years, the trustees must generally obtain a detailed report from a qualified surveyor which must include advice as to marketing the land and the value of the land.

[2] "Designated land" is land held on trusts stipulating that it must be used for the purposes of the charity.

[3] "Cy-près" means "as near as possible". When a charitable purpose cannot be carried out, the Charity Commission or court can direct under a scheme that the funds should be used for other similar charitable purposes.

[4] There are exceptions. (1) Donations from unidentifiable donors (such as through collection boxes, lotteries or sales) can be applied cy-près. (2) If the Charity Commission considers it would be unreasonable to offer a refund, the funds can be applied cy-près. (3) Donations can be applied cy-près if a donor provides a written disclaimer, or fails when invited to provide a written declaration requesting the return of the donation. We propose the retention of (1) and (2) but ask consultees whether (3) is ever used in practice and whether it should be removed.

(2) If granting a lease for seven years or less, the trustees must generally obtain advice on the proposal from someone who they reasonably believe has the ability and experience to provide them with advice.

(3) If the sale or lease is of "designated land"[5] and the trustees do not intend to acquire replacement land, they must also give public notice of the proposed sale or lease and consider any representations made in response.

(4) If granting a mortgage of charity land, the trustees must obtain advice on (i) whether the loan is necessary to pursue the charity's purposes, (ii) whether the terms of the loan are reasonable, and (iii) the charity's ability to repay the loan.

(5) Sales and leases (but not mortgages) to a defined category of "connected persons" are not permitted without the consent of the Charity Commission.

14. We understand that compliance with these requirements can cause charities to incur substantial professional costs and can cause delays in land transactions. Our provisional view is that the requirements should be simplified and streamlined in order to save money and ensure that the legal requirements that apply to a transaction are proportionate to the risks involved. We propose that:

(1) charity trustees should have a duty to obtain and consider advice in respect of a proposed land transaction from a person who they reasonably believe has the ability and experience to provide them with advice; the duty should not, however, apply if the trustees reasonably believe that it is unnecessary to obtain advice;

(2) the duty should be the same in respect of all land transactions, whether sales, long leases, short leases, or mortgages;

(3) the additional restrictions that apply to designated land should be removed; and

(4) the category of connected persons should be removed, and that the general law concerning trustees' duties should apply instead.

15. We also ask consultees whether the new duties on trustees should extend to the acquisition of land, and whether they should extend to exempt charities.[6] We ask consultees for their views on the application of the Universities and College Estates Act 1925 to land transactions and whether the Act should be replaced.

[5] See n 2 above.

[6] Exempt charities include most English universities, other educational bodies, and various museums and galleries: Charities Act 2011, Sch 3.

16. In Chapter 9 we discuss permanent endowment. Permanent endowment is property belonging to a charity that it cannot spend in furtherance of its purposes. It can be divided into:

    (1) "Functional" permanent endowment, that is to say, permanent endowment which is used by a charity directly to pursue its purposes. Examples include village halls and recreation grounds. The charity might be able to sell the property and purchase other property that performs the same function, but it cannot spend the proceeds of sale in carrying out its day-to-day activities.

    (2) "Investment", or "non-functional", permanent endowment, that is to say, a fund which must be invested by the charity (for example in shares, bonds and other securities) to produce an income. The income, but not the fund itself, can be spent on the charity's day-to-day activities.

17. Charities might wish to spend some or all of their permanent endowment. The fund might be so small that the costs of administering it are disproportionate to the income that it yields. Or the charity might want to make a social investment that is expected to decrease in value whilst furthering its purposes. Or the charity might want to carry out major works to the charity's property. We examine the existing statutory powers for unincorporated charities to spend permanent endowment in sections 281 to 282 of the 2011 Act and sections 288 to 289 of the 2011 Act. We conclude that sections 288 to 289, which deal specifically with permanent endowment held on "special trust",[7] serve no useful purpose and provisionally propose that they be repealed. We propose that the power in sections 281 to 282 be extended to incorporated charities and we ask consultees whether the financial thresholds should be increased.

18. We then discuss the possibility of creating a new form of permanent endowment. The restriction on spending permanent endowment is, we think, a blunt, and perhaps ineffective, means of ensuring the perpetual continuation of a charity. It is blunt because it prevents a charity from using its assets in certain ways, even where the trustees' intention is to maintain the value of the fund in the long term. It is potentially ineffective because it does not require the trustees to seek to increase the value of the fund in line with inflation. We discuss whether trustees could instead designate all or part of the charity's permanent endowment as a "preserved endowment fund", which would give the trustees greater flexibility as to how they used the fund while imposing on them a duty to seek to ensure that the real value of the fund is maintained in the long term. We highlight some of the issues that such a regime would have to address and ask consultees whether and how such a regime might work in practice.

PAYMENTS TO TRUSTEES AND OTHER NON-BENEFICIARIES (PART 4)

19. In Chapter 10 we consider whether statute should permit a charity to pay one of its trustees for supplying goods to the charity. A trustee of a charity cannot usually (1) enter into a position where his or her personal interest conflicts, or may possibly conflict, with his or her duties to the charity, or (2) profit by reason of his or her

[7] A "special trust" is property which is held and administered by or on behalf of a charity for any special purposes of the charity: Charities Act 2011, s 287.

position as trustee. These duties, known as the trustee's fiduciary duties, may preclude a trustee from entering into a contract with the charity.

20. Section 185 of the 2011 Act permits a charity to authorise what would otherwise amount to a breach of fiduciary duty by paying reasonable remuneration to a trustee for the provision of services to the charity. These services might include accountancy or legal services (but do not include the performance of the role of trustee). There is, however, no equivalent power to authorise remuneration for the supply of goods; the supply of office stationery at cost price, for example, is excluded. We provisionally propose that such a power be introduced.

21. We also consider whether the Charity Commission should be entitled to award an "equitable allowance" to a trustee who has obtained a profit in breach of fiduciary duty. A trustee who has obtained such a profit must hand it over to the charity, but the court has the power to award the trustee an allowance to reflect the trustee's skill and effort in bringing about the profit. We provisionally propose that the Charity Commission be given a similar power to award allowances in appropriate cases.

22. Chapter 11 concerns ex gratia payments out of charity funds, which are payments that the trustees of the charity feel morally obliged to make but which they have no legal power to make. Such cases typically arise in the administration of wills when a charity's legal entitlement to certain property does not reflect the true intentions of the testator. The charity trustees can ask the Charity Commission for authorisation to make an ex gratia payment. We provisionally propose that charity trustees be given a power to make small ex gratia payments without having to obtain authorisation from the Charity Commission but in accordance with their general legal duties, and we ask consultees about the appropriate financial threshold for such payments.

23. The decision to make an ex gratia payment is one that must be taken by the trustees and not by any other officer of the charity (such as the chief executive or legacy officer). Our provisional view is that that is appropriate, but we ask consultees whether trustees ought to be permitted to delegate the decision to make an ex gratia payment (and if so, up to what size of payment) to another officer of the charity.

INCORPORATION, MERGER AND INSOLVENCY (PART 5)

24. Charities change their organisational form for numerous reasons. An unincorporated charity which has grown over time might benefit from incorporation as a company or CIO for convenience in entering into contracts and to limit the liability of the trustees. A charity's purposes might be better served by merging with another charity, for example, to achieve efficiencies of scale or if a small charity's resources are too small to achieve its purposes effectively. In Chapter 12 we identify some of the problems with the law that governs the merger and incorporation of charities, in particular the provisions of the 2011 Act that deal with the transfer of property, and gifts by will, to charities that have merged.

    (1) Section 268 of the 2011 Act confers a power for charities to transfer their property to another charity, but that power is only available to unincorporated charities with an annual income of £10,000 or less that do

not hold designated land.[8] We ask consultees whether that power should be available to a wider range of charities.

(2) Section 268 imposes more stringent requirements on the exercise of the power to transfer property if that property is permanent endowment as opposed to unrestricted property. We ask consultees whether these requirements are proportionate, or whether the requirements that apply to the transfer of unrestricted property should apply universally.

(3) Where a merger is registered with the Charity Commission, the transferring charity can make a "vesting declaration" under section 310 of the 2011 Act which automatically transfers the transferring charity's property to the new charity. We ask consultees whether that power is satisfactory; whether vesting declarations should be available in respect of leases that contain covenants against assignment; and whether vesting declarations should be available in respect of permanent endowment.

(4) Where a merger is registered with the Charity Commission, gifts by will to the transferring charity are deemed by section 311 of the 2011 Act to take effect as gifts to the new charity. Case law has revealed that this statutory provision is perhaps not as effective as it was first hoped and, in consequence, many "shell charities" exist on the register to capture gifts by will that might otherwise fail. We provisionally propose reforms that would resolve this difficulty.

25. Chapter 13 concerns the insolvency of the trustees of charitable trusts. We examine the current law and identify the circumstances in which trust property is available to discharge the liabilities of a trustee incurred on behalf of the trust and when it is available to discharge the trustee's other liabilities. It has been suggested that there is a lack of clarity concerning the availability of property held on charitable trust in insolvency, particularly where that property is permanent endowment or is held on special trust.[9] It has also been suggested that the insolvency treatment of such property differs depending on whether the trustee is a corporate body or an individual. We conclude that the law treats permanent endowment and special trust property no differently from other trust property, and that the law makes no distinction between corporate and individual trustees when it comes to distributing trust property to their creditors. We conclude that the current confusion could be overcome by the Charity Commission amending its guidance and we make a provisional proposal to that effect.

CHARITY COMMISSION POWERS (PART 6)

26. In Chapter 14 we examine the Charity Commission's current power under section 42 of the 2011 Act to require a charity to change its name. This power can be exercised on any of five grounds. The first ground – that the name of a charity is the same as or too like the name of another charity – can only be invoked in relation to registered charities and within 12 months of registration of the charity. The remaining four grounds are not subject to this limitation and we provisionally propose that it be removed.

[8] See n 2 above.

[9] See n 7 above.

27. The Charity Commission regards itself as unable to refuse to register an institution as a charity (or stay an application for the registration of a charity) on the basis that one of the section 42 grounds applies to its name, unless the institution in question is applying for registration as a CIO. Nor, in relation to a charity that is already registered, can the Commission refuse to enter a new name in the register on one of the section 42 grounds. There is a risk, therefore, that inappropriate names will have to be entered in the register only to be removed again once the Commission exercises the section 42 power. We provisionally propose that the Charity Commission be given a power to refuse to register an institution as a charity, and to refuse to enter a new name on the register, if one of the section 42 grounds is present. We also ask consultees whether the Commission's section 42 power should be exercisable in respect of exempt charities.

28. In Chapter 15 we discuss the power of the Charity Commission to determine the identity of the members of a charity. This power can be used where there is uncertainty as to who the members are and consequential uncertainty as to whether the trustees have been properly elected. We provisionally propose that this power be extended to allow the Charity Commission to determine the identity of the trustees of a charity.

THE CHARITY TRIBUNAL AND THE COURTS (PART 7)

29. Chapter 16 concerns proceedings by charities (1) in the courts, and (2) in the First-tier Tribunal (General Regulatory Chamber) and the Upper Tribunal (Tax and Chancery Chamber), which we refer to as the Charity Tribunal.

30. Court proceedings that fall within the statutory definition of "charity proceedings" in section 115 of the 2011 Act cannot be pursued without the consent of the Charity Commission or, if the Commission refuses consent, the court. The definition of charity proceedings distinguishes between disputes within the charity, such as claims about the way a charity is being run (which are charity proceedings and therefore require authorisation) and disputes with third parties, such as claims for breach of contract (which are not charity proceedings and therefore do not require authorisation).

31. The Charity Tribunal was created by the Charities Act 2006. It hears appeals against various decisions of the Charity Commission, as well as references by the Charity Commission or Attorney General raising questions of charity law. There is no requirement to obtain permission before commencing proceedings in the Tribunal. Our provisional view is that that is as it should be, but we ask consultees whether a permission stage should be introduced into the Tribunal process.

32. Trustees involved in legal proceedings will want to ensure that the costs that they incur (and any costs order made against them) can be paid out of the funds of the charity. The trustees of an unincorporated charity can only pay those costs from the charity's funds if they have been properly incurred. In court proceedings, trustees can obtain a "*Beddoe* order" from the court, which provides them with advance assurance that the proposed proceedings are in the interests of the charity and that the costs incurred by the trustees can properly be paid from the charity's funds. An application for a *Beddoe* order amounts to "charity proceedings" and therefore requires the permission of the Charity Commission. This creates a conflict of interest when the substantive proceedings are against the Charity Commission. In such a situation, we provisionally propose that the trustees should be permitted to seek

authorisation to apply for a *Beddoe* order from the court rather than first having to ask the Charity Commission.

33. A *Beddoe* order cannot be obtained from the Charity Tribunal in respect of proceedings before it. We provisionally propose that the Charity Tribunal be given a power to make *Beddoe* orders in order to provide trustees with a similar level of protection.

34. We then consider whether the Charity Tribunal should be given a power to suspend the effects of a Charity Commission decision to allow a challenge to that decision to be made in the Tribunal. Our provisional view is that while in principle such a power would be desirable, the implications of the exercise of such a power would be complex and potentially detrimental, and that the problem is not sufficiently serious in practice to justify these implications, but we invite the views of consultees on the matter.

35. Finally, we discuss references from the Charity Commission and Attorney General to the Charity Tribunal. We note the current requirement that the Charity Commission obtain the Attorney General's consent before making a reference to the Tribunal and ask consultees whether that requirement should be removed. We also ask whether the Charity Tribunal should have the power to award remedies once it has decided a reference and, if so, which.

IMPACT OF REFORM

36. We ask consultees to share with us their experiences of the operation of the current law in practice and any difficulties that they have encountered, including details of the time and costs involved in complying with the law. We also ask consultees to share their views on the impact of our provisional proposals for reform and whether they would result in costs savings, or additional costs, for charities.

RESPONDING TO THE CONSULTATION

37. The consultation paper, this summary and an optional response form are available on our website at www.lawcom.gov.uk (A-Z of Projects > Charity Law). We invite consultation responses by 3 July 2015.

38. If you wish to respond to all or any of the proposals and questions in the consultation paper, please send your response:

    (1) by email to propertyandtrust@lawcommission.gsi.gov.uk; or

    (2) by post to James Linney, Law Commission, 1st Floor, Tower, Post Point 1.53, 52 Queen Anne's Gate, London SW1H 9AG.

39. If you send your comments by post, it would be helpful if, where possible, you could also send them electronically (for example, by email to the above address, in any commonly used format).

40. For further information about how the Law Commission conducts its consultations, and our policy on the confidentiality of consultees' responses, please see page iii of the consultation paper.