Law Commission
Reforming the law

Technical Issues in Charity Law
Summary

Law Com No 375 (Summary)
14 September 2017

INTRODUCTION

1. Charities occupy a special place in society and the law should both protect and properly regulate them. Our project is intended to further these objectives by removing or adjusting inappropriate regulation while safeguarding the public interest in ensuring that charities are properly run. Charities currently face unnecessary administrative and financial burdens owing to inefficient and unduly complex law. Our Report analyses various technical issues in charity law and makes a number of recommendations for reform.

2. Our project is not a full review of charity law. Our terms of reference relate to selected technical issues. Those issues do not include a number of controversial matters which have recently had a high profile, such as the law of public benefit, the charitable status of independent schools, or fundraising practices.[1]

3. A project on selected issues in charity law was included in our 11th Programme of Law Reform.[2] The project began with a review of social investment by charities in 2014,[3] and our principal recommendations on that topic have now been implemented as part of the Charities (Protection and Social Investment) Act 2016.[4] We then consulted on the remaining issues in our terms of reference – the subject matter of this Report – between March and July 2015,[5] with a supplementary consultation between September and October 2016.[6] We had an enthusiastic response to our consultations and all of the main stakeholders in the charity sector were represented. We are grateful for all the detailed responses we received. Consultation revealed general consensus on some issues and a range of views on others. While on many issues we follow our provisional proposals in the Consultation Papers, in some areas we have departed from them in response to comments from consultees.

4. The Report makes 43 recommendations and includes a draft Bill that would give effect to our recommendations for legislative reform. This Summary provides an overview of the main issues raised in each chapter of the Report, with cross-references to the relevant paragraphs of the Report, in order to help readers to find their way through the paper and identify the recommendations that are of interest to them. Alongside the Report, we have published on our website a marked-up version of the Charities Act 2011 ("the Charities Act") showing the changes that our draft Bill would make to that Act, an Analysis of Responses to our Consultation Papers and an Impact Assessment.

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1 Our Report discusses what should happen when a fundraising appeal raises too much or too little money but does not discuss the way in which charities go about raising those funds, in respect of which a new fundraising regulator has been created.

2 11th Programme of Law Reform (2011) Law Com No 330.

3 Social investment is the use of charitable funds to achieve both a financial return and a social good. This might involve either getting a lower rate of financial return than would be available from a mainstream investment, or accepting reduced liquidity.

4 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 at http://www.lawcom.gov.uk/project/charity-law-social-investment-by-charities/.

5 Technical Issues in Charity Law consultation (2015, CP220).

6 Technical Issues in Charity Law supplementary consultation (2016).

BACKGROUND (CHAPTERS 1 TO 3)

5. In Chapter 1 we explain the role of charities in society, the background to the project and our objectives in recommending reform. These objectives are to remove unnecessary regulation and bureaucracy, whilst ensuring that appropriate regulation is in place; to increase the flexibility of trustees to make decisions in the best interests of their charities; to confer wider or additional powers on the Charity Commission to increase its effectiveness; to ensure adequate protection of charity property; and to remove inconsistencies and complexities in the law.

6. In Chapter 2 we describe the different legal forms of charities and the categorisation of different charities under the Charities Act. In Chapter 3 we comment on a general point raised by a number of consultees about financial thresholds in the Charities Act and recommend that they be reviewed periodically by Government and, if appropriate, increased in line with inflation.

CHANGING PURPOSES, AMENDING GOVERNING DOCUMENTS AND APPLYING PROPERTY CY-PRÈS (CHAPTERS 4 TO 6)

7. Charities can take several different legal forms.[7] A charity may be incorporated, which means that it has a legal personality separate from its trustees[8] 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.

8. 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, the powers and duties of its trustees and rules relating to internal governance (for example, rules on appointing and removing trustees). 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 to 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. The amendment procedures available to a charity depend on its legal form: the Charities Act treats corporate charities differently from unincorporated charities, and charities governed by Royal Charter and by Act of Parliament are subject to special regimes.

9. Chapter 4 focuses on the regimes available to charitable companies, CIOs, trusts and unincorporated associations, and on the differences between them. We conclude that greater alignment of the regimes for corporate and unincorporated charities would be beneficial for simplicity in the law and consistency in its treatment of charities. We recommend a new statutory power for unincorporated charities to make any changes to their governing documents by resolution of the trustees (and, if applicable, the members), with certain amendments being subject to Charity Commission consent:

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7 As set out in Chapter 2 of the Report.

8 By trustees we mean the persons having the general control and management of the administration of a charity, whether or not they are technically trustees of a trust.

paragraphs 4.75 to 4.115 and 4.121. This recommendation reflects the existing statutory powers of charitable companies and CIOs. The requirement for Charity Commission consent provides an important safeguard in respect of more significant and potentially controversial amendments. The new power would replace the statutory powers currently available to certain unincorporated charities, or in respect of certain amendments, under sections 275 and 280 of the Charities Act, which cause numerous problems in practice.

10. We also discuss the specific requirements that apply when corporate or unincorporated charities wish to amend their purposes. Such amendments generally require Charity Commission consent, but the criteria used to determine whether or not to grant consent differs depending on the legal form of the charity in question. Again we recommend alignment of the positions for corporate and unincorporated charities, and propose a single set of criteria which the Charity Commission must consider whenever it decides whether to consent to a charitable company, CIO, trust or unincorporated association changing its purposes: paragraphs 4.123 to 4.139.

11. In Chapter 5 we look at 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 felt by many consultees to be long, bureaucratic and expensive, despite the assistance available from the Privy Council Office, the Department for Digital, Culture, Media and Sport ("DCMS"), and the Charity Commission. Statutory charities must ask the Charity Commission to draft a "scheme" to be approved by Parliament under section 73 of the Charities Act, which can be a lengthy process. Royal Charter charities must ask the Privy Council to approve amendments or to grant a supplemental Charter; again, the processes can be lengthy and expensive for the charity, particularly if the amendment is by way of a supplemental Charter that must be printed on vellum. 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 purposes 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.

12. We recommend a power for Royal Charter charities to amend any provision in their Charter (provided that the amendment cannot already be made using any existing express power of amendment) subject to Privy Council consent: paragraphs 5.44 to 5.56. This recommendation would remove the need to obtain a supplemental Charter. For those cases where a supplemental Charter is still desirable, we recommend that the Privy Council (i) review its policy on publicising petitions in the London Gazette for eight weeks, and (ii) stop requiring supplemental Charters to be printed on vellum: paragraphs 5.61 to 5.69. For statutory charities, we recommend that all section 73 schemes be subject to the negative Parliamentary procedure, which we hope will facilitate the process for those charities who previously had to use the more onerous affirmative procedure: paragraphs 5.115 to 5.118.

13. We consulted on the introduction of a power for statutory and Royal Charter charities to make minor amendments to their governing documents without Parliamentary or Privy Council oversight. In the light of concerns raised by consultees about such an amendment power, we recommend instead that clear and accessible guidance should be provided concerning (i) the process by which amendments can be made, and (ii) the

restructuring of governing documents to enable certain (less important) matters to be amended in the future without oversight: paragraphs 5.72 to 5.107. We hope that this improved guidance will increase transparency and encourage charity trustees to engage in the process of constitutional change where it is in the interests of the charity for them to do so. In addition, we recommend that a user group be established to enable those who engage with the process of amending Charters and bye-laws to propose and discuss practical changes to the procedure.

14. Finally we discuss higher education institutions ("HEIs"), many of which are statutory or Royal Charter charities. We note the significant reforms in respect of English HEIs introduced by the Higher Education and Research Act 2017, which addresses many of the issues raised in our consultation. However, these reforms do not extend to Wales (as education is devolved) and we therefore recommend that the Welsh Government consider introducing guidance (as outlined in paragraph 13 above) tailored for HEIs, as well as removing the rigid requirements for governing documents in the Education Reform Act 1988: paragraphs 5.149 to 5.152.

15. Chapter 6 concerns the situation where too much, or too little, money is raised by a charity in response to a fundraising appeal. Where too much is raised, the Charity Commission can direct that the surplus is applied cy-près.[9] But when too little is raised, the funds cannot usually be applied cy-près and the trustees must instead attempt to contact the donors to offer them a refund.[10] In the case of small donations, the costs of doing so will often be disproportionate to the value of the donation. There is a balance to be struck between protecting donors' wishes and the administrative inconvenience and expense of seeking to contact donors. We do not think that donors would expect (and might even disapprove of) trustees incurring expense in seeking to contact them to offer a refund of a small donation. We therefore recommend that small donations (of up to £120 in a year) be applicable cy-près without the trustees having to take steps to contact the donors, unless the donor provides otherwise when the donation is made: paragraphs 6.36 to 6.46.

16. When the proceeds of a fundraising appeal are applicable cy-près (either because too much or too little has been raised), the trustees can ask the Charity Commission to make a scheme authorising those funds to be used for other similar purposes. In the case of small funds, the costs of obtaining a scheme (both for the charity and the Commission) can be disproportionate to the value of the fund. We therefore recommend that, where a fund that is applicable cy-près does not exceed £1,000, the trustees should be able to resolve that the proceeds be applied for the new purposes without Charity Commission consent: paragraphs 6.70 to 6.80. When deciding on such a resolution, the trustees would be required to consider the desirability of securing that the fund is used for similar purposes.

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

10 There are some complicated exceptions in ss 63 to 66 of the Charities Act, which we recommend simplifying: paragraphs 6.48 to 6.65.

REGULATING CHARITY LAND TRANSACTIONS (CHAPTER 7)

17. Chapter 7 concerns charity land. Charities are subject to restrictions when they sell, let or mortgage their land.

    (1) When 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) When 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"[11] 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) When 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.

18. Compliance with these requirements can cause charities to incur substantial professional costs and can delay land transactions. In our Consultation Paper, we provisionally proposed:

    (1) replacing the regime with a duty on trustees, before disposing of charity land, to obtain and consider advice, but to leave to them the decision as to what advice would be appropriate for a particular transaction; and

    (2) giving trustees a power to dispense with the requirement to obtain advice where they believed that it was unnecessary to do so.

    While there was considerable support for reform, these were particularly controversial proposals, which led to diverging views among consultees. For a number of reasons, set out in the Report, we conclude that proposal (2) would not be appropriate: paragraphs 7.120 to 7.123.

19. Proposal (1) was intended to give trustees the flexibility to obtain advice that is tailored to the particular transaction. Consultees supported this policy, but emphasised the importance of guiding trustees to the right category of adviser and the desirability of obtaining advice from a property professional. We conclude that trustees can be given the desired flexibility to obtain tailored advice, whilst still guiding them to appropriate advisers, by modifying the existing advice requirements.

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[11] "Designated land" is land that is held on trusts which stipulate that it is to be used for the purposes, or any particular purposes, of the charity: Charities Act, s 121.

20. We therefore recommend that the current position, whereby trustees have a duty to obtain and consider advice, should remain. But in order to facilitate the provision of tailored advice, and to reduce the burden of complying with the requirement, we make two recommendations.

    (1) Currently, charities can only obtain advice from a member of the Royal Institution of Chartered Surveyors. We recommend expanding the category of advisers who are entitled to give advice ("designated advisers") to include members of the Central Association of Agricultural Valuers and fellows of the National Association of Estate Agents, all of whom have professional qualifications, are bound by professional conduct rules, and carry indemnity insurance: paragraphs 7.133 to 7.139 and 7.175(1). Trustees will be able to obtain advice from one of those property professionals, when the transaction is within a particular professional's expertise. This recommendation would expand the pool of those who can give advice and enable trustees to select an adviser best suited to the transaction in question. We also recommend that trustees be able to seek advice from designated advisers who are employees or officers of the charity, thus enabling charities to save costs by drawing on available expertise: paragraphs 7.140 to 7.142, and 7.175(2).

    (2) The contents of an adviser's report are prescribed by the Charities (Qualified Surveyors Reports) Regulations 1992. We recommend amending these Regulations to simplify and rationalise the matters which an adviser must set out in a report: paragraphs 7.124 to 7.132, and 7.175(3). That will allow for more flexibility and result in trustees receiving advice that is more pertinent to the charity's needs in respect of the particular transaction.

21. We also make further recommendations to address problems with the existing regime which make the process of disposing of land burdensome for charities. These recommendations include the following.

    (1) We conclude, in light of consultation responses, that the additional statutory requirement to give public notice of disposals of designated land (see paragraph 17(3) above) is unnecessary and burdensome, and should be removed: paragraphs 7.229 to 7.231.

    (2) If charity trustees dispose of land but fail to comply with the advice requirements, purchasers are nevertheless protected if the trustees provide a certificate stating that they have complied with the requirements. The courts decided in 2003,[12] however, that purchasers are only protected by a certificate contained in the disposition (that is, from the point of "completion"); there is no equivalent means of protecting purchasers by including a certificate in a contract for a disposal of land (that is, from the point of "exchange of contracts"). That lack of protection can give rise to additional transaction costs for purchasers and may make purchasers wary of transacting with charities, which would be to charities' detriment. We therefore recommend reform that would result in purchasers being protected by a certificate contained in a contract. We also recommend reform to allow certificates of compliance to be given by the person(s) who are authorised

[12] *Bayoumi v Women's Total Abstinence Educational Union Ltd* [2003] EWCA Civ 1548, [2004] Ch 46.

to sign the contract or conveyance, rather than having to be provided by the charity trustees personally: paragraphs 7.220 to 7.227.

(3) Disposals to "connected persons" require Charity Commission consent (see paragraph 17(5) above) to protect charities against the risk of land being disposed of at an undervalue. We recommend that Charity Commission consent should not be required for (i) a disposal to a wholly-owned subsidiary of the charity, or (ii) a residential lease to an employee of the charity: paragraphs 7.197 to 7.205, and 7.214. The risk of depleting charity assets as a result of making such disposals at an undervalue is minimal, and we conclude that it is disproportionate to require Charity Commission consent to them.

(4) We recommend amendment to the definition of land in the relevant statutory provisions, so that land is no longer subject to the regulatory regime if it is held on trust for multiple beneficiaries (one or more of whom are charities): paragraphs 7.177 to 7.183. In such cases, the general duties on the trustee(s) of the land are sufficient to ensure that the terms of the transaction are to the benefit of all the beneficiaries, including the charitable beneficiaries.

(5) We recommend changes to the Charity Commission's guidance for charities acquiring land, so that it is consistent with the reformed regime for disposals of land: paragraphs 7.233 to 7.243.

22. Finally, we discuss the application of the Universities and College Estates Act 1925 to land transactions, and the specific requirements imposed on the institutions governed by that Act. We recommend that the detailed and complicated provisions of the Act be repealed and replaced with a general power to dispose of land for the small number of institutions to which the Act applies: paragraphs 7.265 to 7.283.

THE USE OF PERMANENT ENDOWMENT (CHAPTER 8)

23. In Chapter 8 we discuss permanent endowment. Permanent endowment is property belonging to a charity that cannot be spent, and falls into the following two categories.

(1) It can be a fund of assets, such as shares, that produce an income to fund the charity's activities. The charity can sell an investment in the fund to purchase another, but it cannot sell an investment and spend the proceeds to further its purposes. This is known as "investment permanent endowment".

(2) It can be property that does not produce an income but is used by the charity to pursue its purposes; for example a village hall or a recreational ground. 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 any sale on its day-to-day activities. This is known as "functional permanent endowment".

24. The definition of permanent endowment in the Charities Act is unclear and inconsistent. It arguably includes funds or assets which would not typically be considered by the charity sector to be permanent endowment. We recommend a reformulated definition which is clear, consistent and more in line with the sector's understanding of the term: paragraphs 8.28 to 8.33.

25. 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 the charity's purposes. Alternatively, the charity might want to use permanent endowment to fund major works to the charity's property. We review the existing statutory powers to spend permanent endowment in sections 281 to 282 and sections 288 to 289 of the Charities Act. Section 281, which applies – broadly speaking – to small funds, allows trustees to spend permanent endowment without Charity Commission oversight. Larger funds can be spent using the power in section 282, but the trustees' decision is subject to Charity Commission oversight. We recommend the following reforms.

    (1) Sections 288 to 289, which deal specifically with permanent endowment held on "special trust",[13] provide a parallel and largely identical regime to that in sections 281 to 282. We conclude that any case that falls within sections 288 to 289 would also fall within sections 281 and 282. Sections 288 to 289 therefore serve no useful purpose and we recommend that they be repealed: paragraphs 8.94 to 8.96.

    (2) The statutory powers under sections 281 and 282 are expressed to be limited to unincorporated charities. That limitation is either redundant (in which case it is confusing) or it excludes a particular category of charities for no good reason. We recommend that the limitation be removed: paragraphs 8.61 to 8.65, and 8.96(1).

    (3) The financial thresholds that determine whether trustees must follow section 281 (which does not require Charity Commission oversight) or section 282 (which does) are confusing and produce arbitrary results. The purpose of the thresholds is to protect larger permanent endowment funds, by ensuring that the release of such funds is subject to oversight. In the light of consultees' comments, we recommend that there should be one financial threshold, based on the value of the permanent endowment fund in question, and that the threshold value should be increased from its current level: paragraphs 8.66 to 8.80, 8.83 to 8.88, and 8.96.

26. We discuss the desirability of enabling charities to borrow from their permanent endowment. We conclude that a power to borrow from permanent endowment would be a useful alternative to the existing power to release permanent endowment restrictions altogether. We therefore recommend that trustees be given a power to spend a portion of the charity's permanent endowment, subject to a requirement that they recoup that expenditure within 20 years: paragraphs 8.124 to 8.136, and 8.145.

27. Finally, we discuss charities who have opted in to what is known as total return investment under the Charities (Total Return) Regulations 2013. Opting in to total return investment enables trustees to invest permanent endowment more flexibly without having to distinguish between capital and income returns. We propose an additional power, for trustees who have opted in to the total return regime, to resolve that permanent endowment may be used to make social investments with a negative or

[13] 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, s 287.

uncertain financial return: paragraphs 8.137 to 8.141, and 8.145. This will enable trustees to engage in a limited form of "portfolio offsetting"; namely offsetting any losses arising from social investments (in circumstances when they pay back less than the initial outlay) against gains elsewhere in the investment portfolio.

PAYMENTS TO TRUSTEES AND OTHER NON-BENEFICIARIES (CHAPTERS 9 AND 10)

28. In Chapter 9 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 position as trustee. These duties, known as the trustee's fiduciary duties, may preclude a trustee from entering into a contract with the charity. But such a contract can be beneficial for a charity; for example, a trustee might be able to provide goods or services on more favourable terms than the charity could obtain elsewhere.

29. Section 185 of the Charities Act permits a charity to pay a reasonable sum as remuneration to a trustee who provides services to a charity other than in his or her capacity as a trustee; for example, a trustee who is an accountant and provides accountancy services to the charity. By enabling the charity to pay the trustee, section 185 authorises what would otherwise amount to a breach of the trustee's fiduciary duty, through profiting from his or her position as trustee. There is, however, no equivalent power to authorise remuneration for the supply of goods; payment for the supply of office stationery at cost price, for example, is not permitted, even though it is of benefit to the charity. We recommend that such a power be introduced: paragraphs 9.6 to 9.12.

30. We explain in paragraph 28 above that trustees' fiduciary duties prevent them from profiting by reason of their position as trustees. A trustee who has carried out work for the charity and in doing so has obtained such a benefit must hand it over to the charity. But the court has the power to award the trustee an "equitable allowance" to reflect the trustee's skill and effort in carrying out work for the charity. Similarly, an award can be made where the trustee has not yet received a benefit (since such a benefit would amount to a breach of fiduciary duty), but where the trustee ought to receive such a benefit to reflect the work that he or she has carried out for the charity. The court will consider various factors in deciding whether to award an equitable allowance, such as whether the charity would otherwise have had to pay someone else to do the work carried out by the trustee. Rather than requiring costly applications for equitable allowances to be made to the court, we recommend that the Charity Commission should have a similar power to authorise a trustee (i) to retain a benefit already received, or (ii) to be remunerated, where it would be inequitable not to do so: paragraphs 9.14 to 9.38.

31. Chapter 10 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 may not reflect the true intentions of the testator. For example, if a testator has left his or her estate to charity and then instructs his solicitor to change the will so as to include a legacy to a family member, but dies before the amendment could be prepared and executed, the charity trustees might want to honour the testator's intentions by making an ex gratia payment to the family member. The charity trustees can currently ask the Charity Commission for authorisation to make

an ex gratia payment. In the case of small ex gratia payments, the costs of seeking that authorisation – and the associated delay – are often disproportionate to the value of the payments. We recommend that charity trustees be given a power to make ex gratia payments that are small relative to the income of the charity without having to obtain authorisation from the Charity Commission: paragraphs 10.5 to 10.27.

32. Currently, 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 a legacy officer). Hence, section 106 of the Charities Act provides that, in order to make an ex gratia payment, the trustees must "regard themselves as being under a moral obligation" to make a payment. We conclude that trustees ought to be permitted to delegate the decision to another officer of the charity, just as trustees can (and are expected to) delegate many other functions, so as to ensure efficiency in charity administration. In order to enable delegation, we recommend that the test for making an ex gratia payment be reformulated to a test of whether the charity trustees could reasonably be regarded as being under a moral obligation to make a payment: paragraphs 10.29 to 10.46. This change does not create any legal obligation to make an ex gratia payment, even if the trustees could reasonably be regarded as being under a moral obligation to make the payment. Moreover, the charity trustees retain overall responsibility for decisions to make ex gratia payments (as with any other decision made by the charity). It will be for trustees to decide whether they wish to decide all ex gratia payments personally, or whether they wish to delegate the decision to make some or all ex gratia payments.

INCORPORATION, MERGER AND INSOLVENCY (CHAPTERS 11 AND 12)

33. Charities change their organisational structure 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 insufficient to achieve its purposes effectively. In Chapter 11 we identify some of the problems with the law that governs the merger and incorporation of charities; in particular the provisions of the Charities Act that deal with the transfer of property, and gifts by will, to charities that have merged.

    (1) Section 268 of the Charities 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.[14] Consultees told us that this power is rarely used since charities generally have express powers to merge in their governing documents. Our recommendations in Chapter 4 will enable unincorporated charities that do not have a power to merge to amend their governing documents so that they have the power to do so. As a result of this recommendation, section 268 will become redundant and we therefore recommend its repeal: paragraphs 11.44 to 11.48.

    (2) Where a merger is registered with the Charity Commission, the transferring charity can make a "vesting declaration" under section 310 of the Charities Act

[14] See n 11 above.

which automatically transfers the transferring charity's property to the new charity. We recommend some technical amendments to section 310 in order to remove uncertainties and confusion as to its operation in respect of certain types of property: paragraphs 11.50 to 11.80.

(3) Where a merger is registered with the Charity Commission, gifts by will to the transferring charity are deemed by section 311 of the Charities Act to take effect as gifts to the new charity. Case law has revealed that this statutory provision is not as effective as it was first hoped. As a result, many "shell charities" (charities that still formally exist but are not operating) remain on the register to capture gifts by will that might otherwise fail. We recommend reforms that would resolve this difficulty and reduce the need for charities to retain shell charities: paragraphs 11.82 to 11.103.

34. Consultees reported that a complicating factor in many mergers is the need to obtain "trust corporation status". A trust corporation is a particular type of corporate trustee, defined in five statutes. In trust administration, there are various advantages to trustees being trust corporations, in particular that a trust corporation, as a sole trustee, can give a valid receipt for the proceeds of sale arising under a trust of land. In the absence of a trust corporation as trustee, at least two trustees are required to give a valid receipt.

35. In most mergers, a charity will transfer its assets to a corporate charity. But permanent endowment will not be transferred to the corporate charity to be held as corporate property; rather, it continues to be held on trust, with the corporate charity becoming the sole trustee of the trust. It will therefore be important for that corporate charity to have trust corporation status so that it can deal with the land (by giving a valid receipt for proceeds of sale). The same is true whenever a corporate charity is to hold any land on trust as a sole trustee.

36. The three current routes to obtaining trust corporation status are cumbersome and time-consuming. The first requires an application to the Lord Chancellor; the second requires a Charity Commission scheme to appoint the trustee; and the third, which is only available to CIOs, requires the merger to be effected by means of a vesting declaration under section 310 of the Charities Act (see paragraph 33(2) above). We conclude that trust corporation status should be more widely available to corporate charities that administer charitable trusts. We recommend that these charities should be given the status automatically: paragraphs 11.118 to 11.132, and 11.136. We also note that more general comments made by consultees about the continuing utility of trust corporation status could be reviewed as part of a trust law project, and that we are considering such a project as part of our forthcoming 13th Programme of Law Reform: paragraph 11.116.

37. Chapter 12 concerns the insolvency of trustees of charitable trusts. We examine the current law and identify the circumstances in which trust property is available to discharge a trustee's 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.[15] 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 explain our view that the

[15] See n 13 above.

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 recommendation to that effect: paragraphs 12.38 to 12.45.

CHARITY COMMISSION POWERS (CHAPTERS 13 AND 14)

38. In Chapter 13 we examine the Charity Commission's current power under section 42 of the Charities Act to require a charity to change its name. This power can be exercised on any one 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 recommend that the limitation be removed: paragraphs 13.35 to 13.38, and 13.43. The section 42 power only applies to charities' formal names; it cannot be used in respect of "working names", which charities use for convenience.[16] An inappropriate working name could mislead the public as much as an inappropriate formal name. We therefore recommend that the power to issue directions under section 42 should extend to working names as well as formal names: paragraphs 13.30 to 13.34, and 13.43.

39. The Charity Commission regards itself as unable to refuse to register an institution as a charity (or delay 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. Similarly, where a charity is already registered but changes its name, and so wishes to enter its new name on the register, the Charity Commission cannot refuse to enter the new name in the register on one of the section 42 grounds. There is a risk, therefore, that inappropriate names have to be entered in the register only to be removed again once the Commission exercises the section 42 power. We recommend that the Charity Commission be given a power to delay the registration of an institution as a charity, and to delay the entry of a new name on the register, for a limited period of time, if one of the section 42 grounds is present: paragraphs 13.45 to 13.60.

40. In Chapter 14 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 discuss whether this power should be extended to allow the Charity Commission to determine the identity of the trustees of a charity. We recognise that such a power might not be appropriate in cases where the Commission would be required to make findings of fact about the identify of trustees in an internal dispute within the charity. Similarly, we decide that a power for the Commission to select who the charity trustees ought to be (as opposed to who the trustees are) would not be desirable. However, we recommend a limited power for the Charity Commission to ratify invalid or uncertain trustee appointments or elections: paragraphs 14.17 to 14.29. This power will enable the Charity Commission to confirm the appointment or election of a

[16] For example, the "RSPCA" is the working name of the Royal Society for the Prevention of Cruelty to Animals.

trustee where there is uncertainty as to whether a particular person was properly appointed or elected.

THE CHARITY TRIBUNAL AND THE COURTS (CHAPTER 15)

41. Chapter 15 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 collectively as the Charity Tribunal.

42. Court proceedings that fall within the statutory definition of "charity proceedings" in section 115 of the Charities 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 proceedings regarding disputes within the charity, such as claims about the way a charity is being run (which require authorisation) and disputes with third parties, such as claims for breach of contract (which do not).

43. 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.

44. In Chapter 15, we address four issues: (i) authorisation to pursue "charity proceedings"; (ii) costs protection in the Charity Tribunal; (iii) suspending decisions pending a challenge; and (iv) the procedure for references to the Tribunal.

45. Trustees of an unincorporated charity 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 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 requirement creates a conflict of interest when the substantive proceedings are against the Charity Commission. We recommend that, where the Charity Commission would face an actual or apparent conflict of interest in giving authorisation to pursue "charity proceedings", charities should have the option to obtain such authorisation from the court instead of the Commission: paragraphs 15.5 to 15.18.

46. A *Beddoe* order cannot be obtained from the Charity Tribunal in respect of Tribunal proceedings. We recommend that the Charity Tribunal be given a power to make "authorised costs orders", which would be equivalent to *Beddoe* orders: paragraphs 15.28 to 15.47. This power will enable trustees who are pursuing proceedings in the Charity Tribunal to obtain advanced assurance that the costs they incur can properly be paid from the charity's funds.

47. When a decision made by the Charity Commission is being challenged in the Charity Tribunal, the Tribunal cannot currently suspend the effects of the decision pending the outcome of the challenge. We consider whether a power to suspend the decision should be introduced. We conclude 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. Instead we recommend that the Charity Commission delay the date on which its decisions take effect to allow time for a challenge (either to the Tribunal or the court) where the decision is likely to be controversial and is not time-sensitive: paragraphs 15.49 to 15.58.

48. 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 the desirability of that requirement. We conclude that the Charity Commission should not be required to obtain the Attorney General's consent before making a reference to the Charity Tribunal and make a recommendation accordingly. However, we recommend that the Charity Commission and the Attorney General should be required to give each other four weeks' advance notice of any intended reference: paragraphs 15.59 to 15.67.

CONCLUSION

49. Our Report covers a wide range of technical issues in charity law. Whilst technical, our recommendations are important and have very real practical consequences for charities. They are designed to improve the protection and the regulation of charities, whilst enabling charities, with appropriate oversight, to work more effectively to achieve their valuable purposes. Implementation of our recommendations would remove uncertainties in the law and unnecessary regulation, which can delay or prevent charitable activities, discourage people from volunteering to become trustees, and force charities to obtain expensive legal advice which is beyond some (particularly small) charities' reach.