

# CHARITY LAW UPDATE

Two of the most eye-catching parts of the recent Charities Act of 2006 were the creation of a brand new legal structure for charities known as the Charitable Incorporated Organisation ('CIO') and the restated requirement that all charities be able to demonstrate that they provide public benefit. It has taken a little while since the Act completed its parliamentary stages in November 2006 but now, at last, the Charity Commission has announced the result of its adjudications on the first group of charities subjected to the public benefit test. Meanwhile the introduction of the CIO draws closer, albeit slowly.

## PUBLIC BENEFIT

It has always been a requirement of charity law that charities must operate for the public benefit. This means, for example, that one cannot establish a charity for the private benefit only of one's own family and friends. Before the Charities Act was passed, however, certain categories of charities were assumed by their very nature to meet this public benefit requirement without scrutiny of any kind; charities for educational purposes were an example of this.

This presumption has now been abolished. All charities (including any new charities which Forsters now set up for our clients) must explicitly demonstrate the ways in which they will provide public benefit in the carrying out of their charitable purposes.

Of course, the most obviously sensitive cases were always going to include fee-paying schools and private hospitals where the majority of the public is, in effect, excluded from benefit by virtue of the level of fees charged. There is clearly an interesting political debate to be had here as to whether an expensive and exclusive private school should enjoy the same tax breaks which come with charitable status as, say, a shelter for the victims of domestic violence in a deprived part of the country.

The Charity Commission selected 12 fee-charging charities to be scrutinised under the reinvigorated public benefit test and published the results of this scrutiny in July. Of the 12 charities selected, two schools and one nursing home were adjudged to have failed the test.

## SCHOOLS FAILING THE PUBLIC BENEFIT TEST

St Anselm's School in Bakewell, Derbyshire was founded in 1888 and has a school roll of approximately 240 pupils, of whom 80 are boarders. The fees range from £6,600 per annum for the nursery school to £17,300 for pupils who board. In attempting to make its education available to the children of less wealthy families, the school advertised bursaries up to a maximum of 90% of its fees (although at the time only two bursaries had actually been awarded so that their value as a percentage of the school's fee income was less than 1%). Other benefits, such as grants from a hardship fund and scholarships of up to 10% of fees were given; other local schools and children were permitted use of some of the facilities.

The Charity Commission found that the school needed to do more to demonstrate that access to its services was not unreasonably restricted to those who could not afford the fees. In particular, it needed to increase access in a way that was targeted at those unable to afford them; this included action to ensure that even people living in poverty were not excluded. For want of these things, the public benefit test was not met. The Governors of the school were already taking steps to address these issues, but the Charity Commission ruled that they must confirm their intention to address the problem within three months and provide a detailed plan, to be agreed with the Charity Commission, within a further nine months.

At this point, it is worth noting that, although a “90% bursary” sounds generous on the face of it, the poorest families could not afford to pay even the remaining 10% of the fees and would remain effectively excluded.

The other school was Highfield Priory School. This has approximately 230 pupils from age 2 to 11 with nursery fees at £29 per day and fees in the main school at £5,795 per annum. The school provided no means-tested bursaries, although it did allow certain use of its facilities by other local schools. The school stated that its policy was to keep the fees as low as possible in order to reduce the financial restrictions on access. Nevertheless the Charity Commission found that the totality of benefits provided for those unable to afford the fees was not sufficient and did not ensure that people in poverty were not excluded. Again, the Charity Commission required the Governors to confirm within three months that they intended to address the points arising and to provide a plan for action within a further nine months.

## SCHOOLS MEETING THE PUBLIC BENEFIT TEST

By contrast, other schools were found to be doing enough to meet the public benefit test and make their education sufficiently widely available. Pangbourne College in Berkshire, for example, (a school with strong connections to the merchant navy) was found to meet the public benefit test. It provided a small number of 100% bursaries and a larger number of minor bursaries and hardship awards, which extended to 24% of the student body. The total value of all these means-tested bursaries and hardship awards represented just under 10% of the school’s gross fee income.

Manchester Grammar School was another example of a school that was judged to meet the new test. The Charity Commission recognised that it may be more difficult for smaller independent schools to be sufficiently generous in their provision than for larger schools (whose resources more easily allow for significant bursary and grant assistance). Nevertheless, the considerable advantages of charitable status come at a price: following the Charities Act 2006, it is now clearly stated that that price is the provision of sufficient public benefit, including benefit to those living in poverty and least able to afford fees of any kind.

## THE STRUCTURE OF CHARITIES & CHARITABLE INCORPORATED ORGANISATIONS

One of the fascinating aspects of charity law for a solicitor working in the field is the wide range of legal forms which a charity can take. Some charities may derive their status from Act of Parliament; others may have been granted a Royal Charter by the Queen, issuing from the Privy Counsel; still more are established as companies. Other charities are created as trusts and others may simply have a constitution agreed upon by a group of founders or settled by means of a “Scheme” of the Charity Commission.

This panoply of legal structures could be sub-divided in a number of ways but, perhaps the most important distinction is between those forms which have their own legal personality (creating a new, separate “person” in law) and those which do not. For example, charitable companies are legally an entity in their own right, quite separate from the directors. By contrast, in the case of a charitable trust or other unincorporated association there is no separate legal personality for the charity; rather, it is the individual trustees or members who together make up the charity.

In many cases, the lack of corporate personality for those charities does not give rise to problems. A classic example is the use of a charitable trust for simple grant-making charities, whose activity consists only of awarding and paying grants to other good causes. By contrast, for a charity with a more complex operational profile (including charities which employ their own staff, own their own premises and regularly enter into contractual relations with third parties) the position can be more troublesome.

If problems arise – say, the charity breaches its contractual obligations to a third party - who is in the firing line? In the case of an incorporated charity, the answer is clear: if a charitable company has committed a breach of contract then one sues the company. But, crucially, if an unincorporated charity is guilty of a breach of contract, then it is the trustees personally who are potentially liable.

In the ordinary course of events, unless those trustees have clearly acted in disregard of their powers or of the best interests of the charity, they would be entitled to be indemnified out of the charity's assets. Legally, however, they remain potentially liable and, in an extreme case, that could mean unlimited personal, financial exposure to the consequences of their default. It is primarily for this reason that larger and more complex charities are routinely advised to operate as a company to give them the protection of the "corporate veil".

If there is a disadvantage of a charity registering as a company, it is the so-called "dual regulator" problem. That is to say a charity that converts into (or is set up as) a company finds itself not only subject to the regulation and scrutiny of the Charity Commission but also, as matter of company law, subject to the oversight of Companies' House. Although the Registrar of Companies might be described as a "light touch" regulator, the additional requirement to file company annual returns, maintain accurate statutory company records and generally comply with company law is an unhelpful additional layer of administrative burden.

For this reason, the voluntary sector was pleased when the Charities Act introduced a brand new vehicle specifically designed for charitable activities, the Charitable Incorporated Organisation. The CIO will have its own corporate legal personality (so that individual trustees are not directly at risk) but it will not be regulated under company law by the Registrar of Companies. It will be a creature solely of the Charity Commission.

Although the Charities Act became law in November 2006, the process of bringing into force all the provisions of the new Act has been a slow one. In particular, there has been a lengthy process of consultation about the details and final form of the CIO and the first of them will not now be created until 2010. Nevertheless, when they do eventually arrive they will be a highly significant new option for charity trustees and their advisers to consider.

This briefing offers general guidance only. It reflects the law as at October 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

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