A question of confidence

Robert Keylock assesses the implications of Mountstar (PTC) v Charity Commission *for charity professionals*

Robert Keylock is a solicitor in the private client team at Forsters LLP

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The Cup Trust caused a furore after the story broke in *The Times* in January 2013, and rightly so. Aggressive tax avoidance schemes are not novel material for the British press, but the exploitation of relief on charitable gifts made this scheme particularly newsworthy. It was described by Margaret Hodge MP, Chair of the Public Accounts Committee as a 'disgusting' abuse of Gift Aid. Aside the obvious concerns raised in relation to the Gift Aid regime, the Charity Commission's initial response to the dealings of The Cup Trust and those involved with the tax avoidance scheme called into question the effectiveness, or perceived effectiveness, of the Charity Commission (the Commission) in safeguarding charitable trusts.

The charity

The Cup Trust (the charity) was established and registered as a charity in 2009. It was administered by a corporate trustee in the British Virgin Islands, Mountstar (PTC) (Mountstar). The original director of Mountstar, Matthew Jenner (Mr Jenner), established the charity as a general grant-making charity, with a view to making grants to charities benefitting children and young adults. Two other directors, Darren Stones (Mr Stones) and John Mehigan (Mr Mehigan) were later appointed (although the latter was, it appears, so unengaged with the charity that, having retired as a director earlier this year, he gave no evidence in proceedings before the First Tier tribunal).

Mr Jenner donated £10,000 to the charity when it was established, and a further £100,000 was donated in 2009/10 as part of another tax avoidance scheme promoted by Mr Jenner. Apart from those donations, virtually the entirety of the charity's funds arose from the Gift Aid scheme promoted by Mr Jenner.

The scheme

The scheme was promoted by a tax advice business run by Mr Jenner and involved a circular series of steps, all of which occurred over the course of a single day.

The charity bought gilts at full value from the trustees of a private settlement called 'The VL Settlement' using funds lent by a Canadian individual. The charity sold those gilts to an intermediary for 0.01% of their value, who then sold them to UK-resident higher rate taxpayers for a nominal sum. The higher-rate taxpayers sold the gilts back to The VL Settlement at full value and 'donated' the proceeds of sale plus a small amount (0.02%) to the charity. The charity used the donations to repay its Canadian lender, and retained the additional 0.02% for its charitable purposes.

Ten 'rounds' of the scheme occurred between January and November 2010 involving around 300 taxpayers. The total value of the transactions in gilts exceeded £176m and it was intended that the scheme would secure £55m in higher rate relief for the participating taxpayers. The charity benefitted from the immediate payment of the 0.02% cash surplus, which amounted to £155,000. It also had (and still has) the prospect of an additional £46m in Gift Aid relief if the scheme is found to be successful. The tax implications of the scheme are currently being scrutinised by HMRC.

Implementation of the scheme and Mountstar's management of conflicts of interest

At the time of the first five 'rounds' of the scheme between January and March 2010, Mr Jenner had retired as a director. He was later re-appointed in 2010/11 when the charity submitted Gift Aid claims for 2009/10 totalling £27m. When the remaining five 'rounds' were carried out between June and November 2010, Mr Jenner followed Mountstar's policy on conflicts of interest, which is based on guidance from the Commission, by refraining from taking part in discussions concerning the scheme.

HNW Tax Advice Partners (HNWTAP), of which Mr Jenner was a partner, charged fees to individual taxpayers for advice on the scheme. Clients paid an up-front fee of 0.4% (which totalled £704,000) and a further 2% (totalling £3.52m) if the scheme succeeded. Until December 2010, Mr Jenner and HNW Partnership Trust (PT) were the only partners of HNWTAP and their interests in the partnership were 95% and 5% respectively. However, Mr Jenner was the sole beneficiary of PT and therefore the ultimate beneficial owner of the full value of HNWTAP.

In January 2011 Mr Jenner gave his interest in HNWTAP to the trustees of a private settlement, The Cherry Cake Settlement, whose beneficiaries included the families of both Mr Jenner and his civil partner. Mr Jenner was therefore unable to benefit directly from the contingency fees, but his and his civil partner's families would ultimately have enjoyed the fees if the scheme were to be successful. Mr Jenner did, however, benefit from the upfront fees of £704,000.

No upfront fees were payable by the charity. However, if the charity secures its £46m Gift Aid payment it must pay the fundraiser for the scheme, Harry Associates, £6.3m pursuant to a fundraising agreement. In practice, however, Harry Associates carried out no fundraising whatsoever because all the donors were referred by HNWTAP.

The Commission's first investigation

In March 2010, following information disclosed by HMRC, the Commission began an investigation into the charity's affairs. The First Tier tribunal (the tribunal), which passed judgment in October 2013, was generally critical of the investigation and, in particular, the manner in which the Commission had investigated Mr Jenner's potential conflict of interest. During the course of the investigation, the Commission failed to obtain evidence from, or communicate with, either of Mr Jenner's co-directors. Instead it relied on Mr Jenner's evidence, notwithstanding that he was the person affected by the potential conflicts of interest.

On counsel's advice, the Commission concluded that the charitable purposes were legitimate and it appeared likely that the charity had been established before the tax scheme was devised and promoted.

The investigation raised concerns about administration matters, reputational risks and conflicts of interest. However, two years after commencing its investigation, the Commission closed its file pending the outcome of HMRC's review of the tax implications of the scheme. On counsel's advice, the Commission concluded that the charitable purposes were legitimate and it appeared likely that the charity had been established before the tax scheme was devised and promoted. The Commission considered that the tax effectiveness of the scheme was a question for HMRC alone. It also concluded that the scheme did not provide any direct or indirect benefit for the directors.

Aftermath of the investigation

A lull followed until *The Times* published an article on 31 January 2013 criticising HMRC and the Commission for a complete failure to tackle a 'massive tax avoidance scam'.

Following *The Times* article, the Commission decided to publish a regulatory case report (RCR) to explain its conclusions from the investigation. The option of reopening the investigation was not considered appropriate at that stage, as no new evidence had come to light.

To assist with the RCR, and at the Commission's request, Mountstar disclosed correspondence with HMRC from 2009/10, but withheld correspondence from 2010/11. When chased for the missing correspondence, Mountstar requested to know why the Commission could not obtain the information from HMRC under 'statutory gateways'. Mountstar was concerned that the Commission was seeking to circumvent confidentiality rules that would otherwise apply to information received from HMRC because information released by HMRC can only be used with HMRC's consent. As a condition to the release of information, Mountstar requested the Commission treat the information as confidential as if it had originated from the statutory gateways. Alternatively, Mountstar proposed that the Commission should accept a summary, on which it could raise any specific questions. The Commission accepted neither proposal.

While discussion about disclosure was ongoing, unbeknown to the Commission, Mountstar had also failed to provide information to HMRC. HMRC had served notices to request information relevant to the Gift Aid claim, and Mountstar defaulted on several occasions, incurring penalties of £3,420.

Before the RCR could be published, the Commission wished to have an open discussion with the directors, either in person or via a conference call. Mr Jenner replied that Mountstar would only accept such a discussion if all three directors were present in person, and it would not be possible to do so for the time being as Mr Mehigan was temporarily outside the UK. Mr Jenner was also asked to provide telephone numbers for his co-directors, which he failed to do. The Commission's troubled dealings with Mountstar served to increase the Commission's suspicions that Mr Jenner was deliberately blocking access to his co-directors. The

Commission began to suspect that Mr Jenner was probably in overall control and therefore at much greater risk of a conflict of interest.

The Commission's decision to open an inquiry and to appoint an interim manager

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This was revealed to the Commission (by HMRC, not Mountstar) in April this year, whereupon the Commission opened an inquiry under s46 of the Charities Act 2011, and effectively seized control of the charity by immediately appointing an interim manager.

In May 2013, Mountstar applied to the tribunal to quash the decision to open an inquiry and the appointment of an interim manager. It argued that the purpose of the inquiry was only to protect the Commission's reputation following the embarrassment caused by press and Parliamentary attention. Mountstar also claimed that the Commission's actions were disproportionate because the charity only had limited funds, unless and until the Gift Aid claim were found to be successful.

Should the Commission's decision to open a s46 inquiry be quashed?

The question for the tribunal was whether the Commission had acted reasonably in opening the inquiry, assessed on the basis of the *Wednesbury* tests, ie did the Commission take into account factors it ought not to have considered? Did it fail to take account of factors it ought to have considered? Or was the decision so unreasonable that no reasonable authority would ever consider imposing it?

Mountstar claimed the Commission failed to take into account, *inter alia*, the following factors:

- HMRC penalties caused no loss to the charity as they were not paid from charity funds. There was, however, no evidence that the Commission was aware of that when it opened the inquiry.
- Mountstar offered to provide documents subject to a confidentiality agreement or in summary form. However, the tribunal considered that the Commission was entitled to receive documentation free from such conditions.
- The Commission did not state all the reasons for its decision to open the inquiry. For example, the Commission did not mention as a reason for the inquiry Mountstar's failure to provide information to the Commission, as opposed to HMRC. The tribunal thought that was irrelevant. The Commission did not need to list every reason; just the principal ones.

On that basis, the tribunal concluded that the inquiry was a reasonable course of action under Wednesbury principles.

Mounstar's second argument was that the inquiry was opened for an improper purpose, namely:

- to vindicate the reputation of the Commission and of the charity sector;
- to appoint an interim manager who could then withdraw the charity's Gift Aid claim; and
- to give the Commission the ability to 'name and shame' individual taxpayers so as to encourage them to abandon their claims for higher rate relief. This proved to be an own goal, as Mountstar's desire to protect taxpayers' confidentiality suggested it was primarily concerned with the interests of the taxpayers rather than the interests of the charity.

The tribunal disagreed that any of these were a primary purpose of the inquiry. It was noted generally that the Commission's decision to open an inquiry was not an automatic response to the press and Parliamentary reaction to *The Times*' article; the Commission had initially decided only to publish its RCR. It was only the lack of co-operation from Mountstar during the course of preparing the RCR, which naturally gave rise to suspicion, that the Commission decided to open an inquiry.

Should the decision to appoint an interim manager be quashed?

Mountstar referred to the serious consequences arising from the appointment of an interim manager and submitted that only serious mismanagement or misconduct could justify such an appointment. In the tribunal's view, the question of whether there had been 'mismanagement' or 'misconduct' requiring the appointment of an interim manager depended on whether Mountstar had acted in way that an ordinary prudent business person would not.

The tribunal considered that the issue of conflicts of interest was critical here, and not merely whether there had been formal compliance with charity policy, but that all potential conflicts were properly considered and actively managed in practice. The Commission identified several actual and potential conflicts, and in particular:

- Mr Jenner's conflicting fiduciary duties towards the charity and, as an employee, towards HNWTAP and its clients.
- Conflicts concerning Mr Jenner's direct and indirect financial interests. The gift of the benefit of the contingency fee to the Cherry Cake Settlement, from which Mr Jenner and his civil partner were excluded, may have been effective to exclude him from having an interest in the fee for tax purposes. However, the tribunal considered it was not effective to exclude a conflict of interest.

> Mr Jenner remained indirectly interested in the contingent fee through the potential benefit to his family.

The tribunal also found that Mountstar had not carried out sufficient due diligence of the tax scheme. An ordinary prudent business person would have carried out an independent review of the scheme, and queried the financial benefit to Mr Jenner. A prudent business person would also have questioned the role of the fundraiser, Harry Associates, and the size of its contingent fee given its entirely passive role in the fundraising process.

The tribunal found that the failures by Mountstar to require a full declaration of Mr Jenner's interest, to ask questions about the scheme and the fundraising costs, and to take independent advice, amounted to serious mismanagement. The directors ought also to have anticipated that the Gift Aid scheme might give rise to doubt about The Cup Trusts' charitable status. In discussing this point the tribunal commented that:

> using the bluntness of an ordinary businessman, it might look like a scheme to extract from HMRC very large sums where the overwhelming beneficiaries, the charity to one side, were private clients of HNWTAP.

The tribunal concluded that it would be 'most surprised' if any ordinary prudent business person would have approved the scheme without having attained a complete understanding of it and without having taken independent advice.

In relation to administrative mismanagement, it came to light that five blank cheques, found by the interim manager in a safe belonging to the charity, had been signed by Mr Jenner and Mr Stones. This was in breach of the charity's financial policy. The cheques were intended to be charitable grants. Mr Jenner explained that, when he signed the cheques in March 2013 it was not clear whether the donee charities would accept the payments due to the publicity surrounding the charity. However, the charity was under pressure to make grants as Mr Jenner had agreed with the Commission to make further payments before 31 March. The tribunal considered that charity trustees must never sign blank cheques, and that this was clear evidence of mismanagement. The tribunal found that the evident panic to sign cheques before 31 March was:

> an illustration of [Mr Jenner's] inability to discharge his duties in any way other than through the prism of a specialist tax adviser, where the significance of this sort of thing may well be different.

In the light of all these points, the tribunal found that Mountstar was clearly unable to discharge its duties as a trustee, and that the appointment of an interim manager was proportionate and necessary.

Should the Charity Commission concern itself with taxation matters?

The Commission maintained throughout the proceedings that the legitimacy of the scheme was a question for HMRC alone. The tribunal disagreed with that view. The Commission's statutory objectives include the promotion of compliance by charity trustees with their legal obligations, and to a standard expected of an ordinary prudent business person. Where charity trustees become involved in a tax avoidance scheme, a review of those activities by the Commission must necessarily involve a review of the scheme itself, including the way in which the scheme interacts with taxation legislation, as a prudent business person would do so. In summary, the tribunal considered it was appropriate for the Commission:

> to rigorously and vigorously analyse and scrutinise the scheme itself and each step in and of the transactions and of the entities and individuals behind them.

Conclusions for practitioners

Despite the tribunal's criticism of the Commission's first investigation, the decision vindicates the Commission in relation to its subsequent actions. With an interim manager now in place, many aspects of the tax scheme can perhaps be unravelled. The interim manager will no doubt disclose to the Commission and HMRC all documentation in its possession relevant to the scheme. It seems likely that the manager will also wish to seek to withdraw the Gift Aid claims (although, if that happens, individual donors will still able to proceed with their claims for higher rate relief independently of the charity if they wish). The tribunal also suggested that the interim manager may wish to commence an action to recover scheme fees paid to Mr Jenner and his associates, in light of the tribunal's conclusions that there were clear conflicts of interest.

Taking a broader view, there are many lessons to be learned from this. For charity trustees, it is the importance of actively managing conflicts of interest and to become fully conversant with any proposed arrangements with which the charity may wish to become engaged. For the Commission it is perhaps the need to ensure it actively fulfils its overarching statutory objectives as the regulator of the charity sector, and particularly to safeguard public confidence in the sector. For government and parliament, the case raises difficult questions about the interaction of charity law and taxation. Gifts to charities are seen as, primarily, altruistic acts, but incentivising such gifts through a system of tax reliefs has undoubtedly improved the lot of a great many charities. Such incentives must, however, be carefully monitored to ensure that they are not abused. ■

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Associated Provincial Picture Houses v Wednesbury Corporation
[1948] 1 KB 223

Mountstar (PTC) v the Charity Commission
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