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This issue of the *International Journal of Not-for-Profit Law* features three articles on Europe. The first one examines cross-border issues in regulating charities, concentrating on Ireland and the UK. The authors are Oonagh B. Breen of the School of Law, University College Dublin, Ireland; Patrick Ford of the School of Law, University of Dundee, Scotland; and Gareth G. Morgan of the Centre for Voluntary Sector Research, Sheffield Hallam University, England. Next, Goran Buldioski, director of the Open Society Institute's Think Tank Fund, assesses the need for a code of ethics on the part of think tanks in Central and Eastern Europe. Finally, Pesh Framjee, Partner and Head of the unit serving Non-Profit Organisations at Horwath Clark Whitehill, provides a comprehensive guide to the law regulating trading by charities in the UK.

We also feature an article and a review. In the article, Mahammad Guluzade and Natalia Bourjaily evaluate the prospects for developing legislation and practice for charity in Azerbaijan. And Michael Bisesi, Professor and Director, Center for Nonprofit and Social Enterprise Management, Seattle University, reviews a Center for Effective Philanthropy monograph, *Beyond the Rhetoric: Foundation Strategy*.

As always, we gratefully acknowledge our authors for their incisive and informative articles.

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Europe

Cross-Border Issues in the Regulation of Charities: Experiences from the UK and Ireland

Oonagh B. Breen,* Patrick Ford, and Gareth G. Morgan*****

Drawing on the specific experience of the three authors across the four jurisdictions of England and Wales, Scotland, Northern Ireland, and the Republic of Ireland, this article outlines the new legal-regulatory framework for charities in each jurisdiction, providing an overview of their respective treatments of external charities (i.e., non-domestic charities operating in a host jurisdiction) before assessing the operational challenges posed by these regimes for such cross-border charities. It shows that the treatment of external charities across the four jurisdictions is not the product of a fully coordinated and coherent joint approach by the four sets of legislators. The article concludes by offering some preliminary recommendations intended to address the burdens caused by these overlapping regulatory systems.

1. INTRODUCTION

1.1 Regulation of the Third Sector

The islands of Britain and Ireland share a common history of charity law dating back to the 1601 Statute of Charitable Uses. However, these islands now comprise four separate legal jurisdictions: (a) England and Wales, (b) Scotland, (c) Northern Ireland (which together comprise the United Kingdom), and (d) the Republic of Ireland. In recent years, all four have embarked on major changes to their respective regimes of charity law with the introduction of the Charities and Trustee Investment (Scotland) Act 2005, the Charities Act 2006 (for England and Wales) and the Charities Act (Northern Ireland) 2008 and the Irish Charities Act 2009, respectively. These four pieces of legislation, though not yet fully implemented, have much in common: they all seek to introduce modern systems of charity law, with new legal definitions of the term “charity,” compulsory registration of “charities,” and more precise requirements for charity accounting – with requirements at various levels based on the income of the charity.

Despite these apparent similarities, there are many differences, which have the potential to create great difficulties when charities are active in more than one jurisdiction – we refer to these as “cross-border charities.” For example, many charities established and registered in England and Wales are required in addition to register in Scotland if they have significant

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activities in Scotland. In some cases this requirement may force them to amend their governing documents to meet the Scottish definition of “charity.” They must then comply with the tighter accounting requirements for Scottish charities – even though their principal regulator is the Charity Commission for England and Wales.

Under the Irish Charities Act, which follows the Scottish approach, foreign charities operating in Ireland will also need to register with the proposed Charities Regulatory Authority. Similarly, the Charities Act (Northern Ireland) makes registration compulsory for any foreign charities operating in Northern Ireland (albeit on a separate register from domestic charities). The net effect of these new statutes is that charities operating throughout the United Kingdom and Ireland may soon find themselves required to register up to four times, and may face enormous obstacles in ensuring that their governing documents, their published accounts, and their fundraising procedures meet the various jurisdictional requirements. It is possible that some charities offering cross-border services may choose to withdraw services from beneficiaries outside their main jurisdiction rather than deal with the legal complexities of multiple registration. This article examines how the new legislative framework in each jurisdiction affects external or “foreign” charities and considers the practical implications for charities that operate within two or more of the four jurisdictions.

1.2 Charitable Status and Jurisdiction

The ways in which countries and regions choose to regulate non-profit organizations (NPOs) can be revealing as to whether such organizations are viewed as entities to be valued and supported (in which case the regulatory focus is likely to be one that aims to engender trust and build confidence in NPOs) or whether they are seen as potentially high-risk organizations (requiring tight regulation to prevent abuse). By its nature, such regulation may be either *controlling* (one might think, for instance, of the requirement for permit approval in order to fundraise or the requirement to seek court or regulator approval before varying certain nonprofits’ mission objectives) or *facilitative* (for example, the granting of additional tax reliefs to or the imposition of modified filing or disclosure requirements on certain categories of nonprofit organizations that are less demanding than those applied to for-profit bodies).

A key aspect of nonprofit regulation relates to the granting of charitable status. The significance of charitable status can vary considerably between different countries and jurisdictions. In the past, with the exception of England and Wales – which has long had a well-established regulatory framework for charities overseen by a statutory regulator (the Charity Commission) – recognition of a nonprofit organization as a charity has been primarily a matter of tax law. To this end, the relevant tax authority may have awarded a nonprofit organization charitable tax-exempt status based on tax law criteria but no greater conclusions regarding the governance or operation of that organization could be drawn from its tax status other than to say that at the date of the award it had purely charitable purposes. In contrast, charitable status in England and Wales has, relatively speaking, indicated that the organization in question meets the higher governance and regulatory standards in the past imposed by the Westminster Parliament and enforced by the Charity Commission. In all cases, charitable status brings with it legal protection of charitable assets with the intervention of regulators or the courts, if necessary, to ensure that charitable property is not misapplied.

With the advent of the new charity legislation discussed below, the right to call one’s organization a ‘charity’ or ‘registered charity’ will be predicated upon nonprofit organizations

fulfilling certain mission, governance and financial reporting requirements.¹ In short, with perhaps the exception of small organizations in England and Wales with less than £5,000 income,² every domestic voluntary organization in the UK or Ireland that wishes to hold itself out as a “charity” or as having “charitable objectives” will before long either be required to register with the appropriate charity regulator³ and be subject to the appropriate framework and protection of charity law – or it will be clearly non-charitable. Recognition of a non-profit as a charity will thus bring domestic nonprofit organizations within a regulatory framework that focuses as much on issues of governance as on taxation.

As between jurisdictions, the conditions under which charitable status is granted, however, vary by degree. It follows that a charity in one jurisdiction has no guarantee that it will necessarily satisfy the charity test in a neighboring jurisdiction in which it wishes to operate. For those external organizations eligible to register, the parity of treatment with domestic charities that such registration imposes will disregard, to a large extent, the fact that such external charities may already be subject to a charity supervisory regime operated by the charity regulator of their home jurisdiction.

1.3 What is a Charity?

In the UK and Ireland, charitable status – even when previously recognized only in tax terms – has long been a matter not of registration, but about the nature of an organization in terms of its objects and the benefits it bestows.

Recent legislation, discussed below, has updated the definition of a “charity” – but does not alter the central principle of charitable status, which in all four jurisdictions is defined in terms of organizations with specific objects (falling within the so-called “heads of charity”) and meeting the test of public benefit. In England and Wales, for example, an organization subject to the law of England and Wales which meets the tests of charitable objects and public benefit *is* a charity, regardless of registration with the Charity Commission or HM Revenue and Customs or any other body. In Scotland, on the other hand, a body does not become a charity until registered, but in order to be registered must meet a “charity test” incorporating criteria broadly similar to those in England and Wales. Similar principles apply in the other jurisdictions under discussion – although there are variations in the precise heads of charity allowed, and in the definition of public benefit.

The legislative changes considered in this article make charity registration compulsory to a large extent. For example, in Scotland, as explained below, a body cannot normally make any claim to charitable status unless it is entered on the Scottish charity register, and only limited exceptions are made for charities established in other jurisdictions but with activities in Scotland.

¹ See the Appendix for comparison of the charity accounting requirements. In each jurisdiction, the accounts of larger charities (over £500,000 income in the UK or a figure to be prescribed in Ireland but not exceeding €500,000) are (or will be) subject to professional audit, and below this a lesser regime of independent examination applies. For further discussion of the latter see Gareth G. Morgan, “Charities and Self-Regulation: Theory and Practice in the Role of Independent Examiners under s.43(3) of the Charities Act 1993” (2005) 8(3) *The Charity Law and Practice Review* 31-54.

² Charities Act 1993 ss. 3, 3A, 3B (as amended by ss. 8-9 of Charities Act 2006, implemented from 31 Jan 2009).

³ *These are:* Charity Commission for England and Wales (CCEW), Office of the Scottish Charity Regulator (OSCR), Charity Commission for Northern Ireland (CCNI), and the Irish Charities Regulatory Authority (CRA).

This increased compulsion on charity registration can have unexpected consequences – for example, a single charity could be simultaneously subject to registration with a number of separate charity regulators, and could be subject at the same time to more than one charity accounting regime.

1.4 Jurisdictions and Cross-Border Issues

This article focuses on issues of charity regulation in two nation states – the UK and Ireland – but since the UK has three different legal systems (for England and Wales, Scotland, and Northern Ireland) this gives four separate jurisdictions in all, as shown in Table I.

Table I: Legal jurisdictions in the UK and Ireland

<i>Country</i>	<i>Jurisdictions</i>	<i>Geographical Terms</i>
United Kingdom (UK)	England and Wales (E&W)	Britain (or Great Britain)
	Scotland	
	Northern Ireland	Island of Ireland
Republic of Ireland	Ireland	

All references in this article to “Ireland” and “Irish,” unless otherwise qualified, relate to the Republic of Ireland. The primary aim of this article is to explore the consequences of subtle differences of charity law between different jurisdictions, using the four systems of charity law which apply across the UK and Ireland as specific cases. It focuses, in particular, on the issues for *cross-border charities* (that is charities, whose activities – whether in service provision or fundraising – operate across more than one jurisdiction). Because of the relatively high population density and close social and economic ties within the islands of Britain and Ireland, it is common for a single charity to be working in more than one of the four jurisdictions, so the issues for cross-border charities are sharply focused.⁴

1.5 Terminology and Article Structure

As explained above, a *cross-border charity* is defined as a charity whose activities extend across more than one jurisdiction – and which may, therefore, be accountable to more than one charity regulator.

In each jurisdiction, a distinction is made between *local charities* (or *domestic charities*) and *external charities*. For example, a charity established under the law of England and Wales is a local charity in the context of England and Wales. But if this charity starts to raise funds or to provide charitable activities from premises in Ireland it becomes liable to regulation as a charity in Ireland. In the context of Ireland, we describe it as an external charity. Formally, we define an

⁴ The Office of the Scottish Charity Regulator in its 2008 Consultation Paper on Monitoring of Cross Border Charities identified 450 cross-border charities on the Scottish Charity Register with roughly ten new cross-border applications being received each month: see OSCR, *Monitoring of Cross Border Charities: Proposals for Consultation* (2008), at 2. (The number has been updated to 530 in OSCR’s submission to the Calman Commission on Scottish devolution: see OSCR, *OSCR Response to the Calman Commission* (February 2009).)

“external charity” as a body established and recognized as a charity under a “foreign” jurisdiction but which has activities or a presence in the jurisdiction under discussion.

Where monetary limits are discussed, the relevant local currency is used as in the relevant legislation – so monetary limits applicable to the UK jurisdictions (England and Wales, Scotland, Northern Ireland) are expressed in pounds sterling (£) whereas monetary limits in the Irish jurisdiction are expressed in euro (€).

Sections 2 to 5 of the paper consider in turn each of the four jurisdictions under discussion, namely England and Wales, Scotland, Northern Ireland, and Ireland. In each of these sections, a brief summary is given of the main features of charity law in the jurisdiction concerned, followed by a description of how that system of charity law affects external charities operating in that jurisdiction (as defined above). Section 6 reports some early non-statutory arrangements for cooperation between charity regulators in these jurisdictions. Section 7 of the paper appraises the cumulative effect of these, at times, competing provisions, with the conclusion (section 8) offering, in light of this evaluation, some recommendations to policy makers.

2. ISSUES FOR EXTERNAL CHARITIES OPERATING IN ENGLAND AND WALES

2.1 Outline of the Charity Legal Framework in England and Wales

In England and Wales, the Charities Act 2006 (amending the Charities Act 1993) introduced a new definition of “charity,” which came into effect from 1 April 2008, updating the long-established common law definition. The face of the 2006 Act states what has been a matter of case law for centuries,⁵ namely that a charity is an institution established exclusively for charitable purposes.⁶ A charitable purpose must satisfy two tests:

- (a) the purpose must fall within the list of 13 possible “heads of charity”⁷ (this is broadened extensively from the former four heads established in case law⁸); and
- (b) the purpose must be for the public benefit.⁹

Although this definition of “charity” only extends to England and Wales in terms of the protection of charitable property and the powers of the Charity Commission, it applies throughout the United Kingdom for the purposes of tax law.¹⁰ This has consequences even for local charities established in Scotland and Northern Ireland: for example, most recently established Scottish charities have their objects worded in a way that ensures the organization will be charitable *both* under Scottish law (in terms of registration as a Scottish charity) and under English law (to ensure it gains the UK tax benefits of charitable status).

⁵ Peter Luxton, *The Law of Charities* (Oxford: OUP, 2001).

⁶ 2006 Act, s.1.

⁷ 2006 Act, s.2(2).

⁸ The key case is the judgment of Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531 (hereafter *Pemsel*).

⁹ 2006 Act, s.3.

¹⁰ 2006 Act, s.80.

The Charity Commission (for England and Wales) (“CCEW”) is the government department charged with regulation of charities. In most cases, charities established under the laws of England and Wales are required to register with the Commission, but there are significant exceptions to the general principle. Whilst many voluntary organizations in England and Wales see charity registration as an optional badge, this is not the case in law: if an organization is a charity, registration is normally compulsory if its income is over £5000 pa.¹¹

Some charities (for example, places of worship, armed forces charities) are for the time being excepted from this requirement up to a higher threshold of £100,000 income¹² – but these “excepted charities” are nevertheless subject to most of the requirements of the Charities Act 1993, even though not required to register with the Commission. Moreover, in due course this £100,000 limit will be reduced by Ministerial Orders.¹³ There is also a category of “exempt charities,” which includes universities and charities constituted as community benefit societies.¹⁴ These have the benefits of charitable status without direct oversight by the Charity Commission, but this category, too, is effectively removed by the 2006 Act except where there is a “principal regulator” that can take the place of the Charity Commission in regulating their use of charitable funds.¹⁵

All charities established in England and Wales are required to produce annual statements of accounts, which are public documents. Different thresholds are set, mainly according to the income of the charity, in terms of the presentation of the accounts and the level of external scrutiny required.¹⁶ These requirements are summarized in Table II in the Appendix to this article. Although legislators have made some attempts to align thresholds between the three UK jurisdictions (England and Wales, Scotland, Northern Ireland), as discussed later, a number of the thresholds for England and Wales are higher (and so less demanding) than in Scotland and in Northern Ireland.

The CCEW has a very wide range of roles in the regulation of charities, some of which date back more than a century. A permanent body of Charity Commissioners was established in 1853 and a systematic register of charities was first created by the Charities Act 1960. The Charities Act 1992 (most of which was subsequently consolidated into the Charities Act 1993) gave the Charity Commission a wide range of powers and introduced the accounting arrangements. However, it was only with the 2006 Act that the Commission was given specific objectives, such as increasing public confidence in charities and promoting compliance by charity trustees with their legal obligations.¹⁷

¹¹ Charities Act 1993, s.3 – as amended by the Charities Act 2006 (Interim Changes in threshold for registration of small charities) Order 2007 (SI 2007/789).

¹² 1993 Act, s. 3A(2) – as inserted by s.9 of the 2006 Act. The registration of excepted charities over £100,000 income became compulsory from 31 January 2009 – prior to that date, charities which fell within the exceptions could avoid registration regardless of income.

¹³ 1993 Act, s. 3A(7).

¹⁴ *I.e.*, Societies established for the benefit of the community under the Industrial and Provident Societies Acts – the new name arises from the Co-operative and Community Benefit Societies Act 2003, s.1(9).

¹⁵ 2006 Act, ss.11-13.

¹⁶ For further details, see Gareth G. Morgan, *The Charity Treasurer's Handbook: An Introduction to Voluntary Sector Finance and Accounting* (2nd ed., London: Directory of Social Change, 2008).

¹⁷ 1993 Act, s. 1B, inserted by 2006 Act, s. 7.

Under the 1993 Act, the Commission is given extensive powers to institute inquiries into charities,¹⁸ and, where it deems this necessary, it has powers to institute searches, to suspend trustees, to restrict the transactions which a charity can undertake, to direct the application of property *cy-près*, to appoint an interim manager to a charity, and to make directions on the application of charitable property.¹⁹ Nevertheless, it is now possible to challenge most of the Commission's decisions without going to Court, by means of an appeal to the Charity Tribunal.²⁰

2.2 Issues for External Charities Operating in England and Wales

Despite being recently updated by the Charities Act 2006, the framework of charity legislation in England and Wales is almost completely silent on the issue of external charities. There are no circumstances in which external charities could be required to register with the CCEW – unless an external charity established a separate local charity under the laws of England and Wales. It follows that the requirements for registration of charities in England and Wales and the regulatory powers of the Charity Commission are almost entirely restricted to charities established under the law of England and Wales.

This issue of whether the English courts (and hence the Charity Commissioners²¹) had any jurisdiction within the Charities Act 1993 over a charity established elsewhere was tested in the case of *Gaudiya Mission v. Brachmachary*,²² in which the plaintiff, an Indian charity, challenged the claims of an English charitable trust with similar objects. The key issue was whether or not the case constituted “charity proceedings” for the purposes of s.33 of the Charities Act 1993: if so, the plaintiff could only bring the case with the permission of the Charity Commissioners. On appeal by the Attorney General, this argument was rejected. The Court ruled that the definition of “charity” in s. 96(1) of the Charities Act 1993 did not extend to a charity established under the laws of another legal system.

The Charities Act 2006 takes account of this prevailing jurisprudence relating to English courts' jurisdiction over external charities. It follows that a charity established under Irish, Scottish, or Northern Irish law *will not* be a charity within the meaning of section 1 and will not therefore be eligible (or required) to register. The new definition of “charity”²³ refers to an institution which is established for charitable purposes only and which is subject to the control of the High Court²⁴ in the exercise of its jurisdiction with respect to charities. Virtually all references to the term “charity” in the Charities Act 1993, as amended, cross-refer to this definition.²⁵

There is a very limited protection in England and Wales for the use of the term “registered charity,” as a result of the provisions of the Charities Act 1992 concerning

¹⁸ 1993 Act, s. 8.

¹⁹ 1993 Act, ss. 9-19B – as amended.

²⁰ 1993 Act, ss. 2A-2D, inserted by Charities Act 2006.

²¹ The Charity Commissioners only became incorporated as “The Charity Commission” under s1A of the 1993 Act inserted by s. 26 of the 2006 Act.

²² *Gaudiya Mission v. Brachmachary* [1998] Ch 341 (C.A.) (hereafter *Gaudiya Mission*).

²³ 2006 Act, s. 1(1).

²⁴ *I.e.*, The High Court of England and Wales.

²⁵ 1993 Act, s. 96(1), as amended by the 2006 Act, s75, Sch 8, para. 173(2).

fundraising. Under s. 63 of the 1992 Act it is an offense to solicit money or property for an institution with a representation that it is a registered charity when it is not (and “registered charity” is defined as a charity registered with the CCEW). It follows that trustees and officers of external charities may not use this term in their fundraising materials without qualifying it in some way – such as “Scottish registered charity.” But this only applies to fundraising – no offense is created if the term “registered charity” is used by an external charity in the context of promoting its work to potential beneficiaries.

One small exception to this lies in sections 10 to 10C of the 1993 Act,²⁶ which relate to the powers of the Charity Commission to disclose information – these sections extend to the whole of the UK, although the impact may be wider still.²⁷ Under these sections, the CCEW may disclose information to other charity regulators and public authorities (including HM Revenue and Customs) and may receive disclosures from such bodies. The definition of “public authorities” includes any body discharging functions of a public nature, even if established *outside* the UK, though disclosures must comply with the Data Protection Act 1998 and the Regulation of Investigatory Powers Act 2000.²⁸ On this basis, the CCEW could cooperate with other charity regulators anywhere in the world. But the only way in which the CCEW could act against an external charity operating in England and Wales would be by using these disclosure powers in order to persuade the relevant regulator in the charity’s home jurisdiction to take action.

The CCEW is also given specific powers²⁹ in relation to Scottish charities which are “managed or controlled wholly or mainly in or from England and Wales” and in relation to charitable property held by a person in England and Wales on behalf of a Scottish charity.

However, apart from these special cases, in most instances where a concern arises in England and Wales with regards to the activities of an external charity established in Scotland or Northern Ireland, the powers of the CCEW appear to be limited to drawing the matter to the attention of Office of the Scottish Charity Regulator (OSCR) or the Charity Commission for Northern Ireland (CCNI) as appropriate – or to other UK public authorities where appropriate.

Nevertheless, rather more extensive powers arise in England and Wales in the case of fundraising, which can affect external charities. Part 3 of the Charities Act 2006 introduces new regimes in England and Wales for the regulation of (1) public charitable collections; (2) disclosures to be made by professional fundraisers and commercial participators; and (3) reserve powers to regulate fundraising in general.³⁰ The definitions used in Part 3 of the Act extend to any collection or appeal made “in association with a representation that the whole or any part of

²⁶ 1993 Act ss. 10, 10A, 10C, as amended and inserted s. 75(1) of 2006 Act: Sch 8 para. 104.

²⁷ 1993 Act, s. 100(3), as amended.

²⁸ 1993 Act s. 10C, as amended.

²⁹ 1993 Act, s. 80, as amended by 2006 Act s. 75(1) Sch 8, para 96 and by Charities and Trustee Investment (Scotland) Act 2005 (Consequential Provisions and Modifications) Order 2006 (SI 2006/242) art. 5, Sch, Part I, para. 6.

³⁰ Apart from the new disclosures by professional fundraisers, etc (which took effect from 1 April 2008) these provisions are yet to be implemented. According to bulletins from the Government’s Office of the Third Sector, the new regime on public collections is due to be implemented from 2009/10. The reserve powers to regulate fundraising more generally will only be implemented if the Government judges that the self-regulatory scheme established by the Fundraising Standards Board (*see* www.frsb.org.uk) is not working effectively after five years.

the proceeds is to be applied for charitable, benevolent or philanthropic purposes³¹ and to charitable institutions and persons or bodies connected to them.³² The terms are defined to include any institution established for such purposes³³ – there is no requirement for it to be subject to the High Court of England and Wales. Indeed, even a non-charitable entity, such as a fundraising business, is caught by these requirements.

So, external charities operating in England and Wales are clearly caught by the arrangements for regulation of fundraising – but no more so than a commercial business would be caught if it sought to raise funds with a representation that the funds would be applied for charitable purposes. There is, however, no power in England and Wales to require external charities to prepare financial statements or to account to the Charity Commission in respect of their charitable funds.

3. ISSUES FOR EXTERNAL CHARITIES OPERATING IN SCOTLAND

3.1 Outline of Scottish Charities System

Scotland has its own common law of “charities” or “public trusts,”³⁴ but this indigenous law is often lost sight of because the technical English definition of charity has long been the criterion for the concession of “charitable” tax reliefs in Scotland under United Kingdom taxation statutes.³⁵ When the United Kingdom Parliament, in Part I of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990, provided for the first statutory system of charities regulation in Scotland,³⁶ the English definition, already familiar for tax purposes, was used to define “Scottish charities” for regulatory purposes also. Under that Act a “Scottish charity” was a body established under the law of Scotland (or managed or controlled from Scotland) and recognized by the United Kingdom tax authorities as eligible for charitable tax relief.³⁷

By comparison with the long-established system of charities supervision in England and Wales, the system for the supervision of Scottish charities under the 1990 Act was an unsophisticated one, with no true equivalent of the CCEW as a registrar-regulator and no definitive register of charities.³⁸ The Charities and Trustee Investment (Scotland) Act 2005 cured

³¹ 2006 Act, s. 45(2).

³² 2006 Act, s. 69.

³³ 2006 Act, s. 47(1) and the future s. 64A(7)(b) of the Charities Act 1992, which will be inserted by s. 69 of the Charities Act 2006.

³⁴ See generally Lord Ross and others, “Trusts, Trustees and Judicial Factors” in *The Laws of Scotland: Stair Memorial Encyclopaedia*, vol. 24 (1989), paras 85-111.

³⁵ See *Pemsel*, *supra* n. 8. This arrangement has been continued by the Charities Act 2006, s. 80(3) and (4), so that the adjusted definition of charity provided for in ss.1 to 3 and 5 of that Act applies in Scotland for tax relief purposes.

³⁶ Scottish public trusts are supervised at common law by the Court of Session. The Court of Session, of which the Outer House judges hear cases at first instance and the Divisions of the Inner House hear appeals, is a civil court with functions broadly equivalent to those of the High Court and Court of Appeal in England and Wales.

³⁷ Law Reform (Miscellaneous Provisions) (Scotland) Act 1990, s. 1(7).

³⁸ The Lord Advocate had powers of investigation and very limited powers of intervention, which were transferred at devolution to the Scottish Ministers and exercised by them through OSCR as an executive agency: *see* 1990 Act, s.7; Scotland Act 1998, s.53; and Transfer of Functions (Lord Advocate and Secretary of State) Order

these deficiencies by setting up a full-fledged statutory regulator of charities in Scotland, OSCR,³⁹ modeled broadly on the CCEW, one of whose principal functions is to keep a public register of charities.⁴⁰

In one important respect, however, the new Scottish system departs significantly from both its English model and its predecessor under the 1990 Act. The devolved Scottish Parliament chose to sever the connection between the United Kingdom tax system and the regulation of charities in Scotland,⁴¹ abandoning the tax definition of “charity” – that is, the English definition – as the touchstone of Scottish charitable status for regulatory purposes, and devising instead a new “charity test,”⁴² adapted from the English definition but different from it. Thus, while a body becomes entitled to call itself a “charity” in Scotland (and is correspondingly subject to regulation) only by meeting the charity test and being entered by OSCR in the new register, the body is granted “charitable” relief under United Kingdom taxation statutes by reference to the English definition of charity, as now revised by the Charities Act 2006.⁴³

The charity test is similar to the revised English definition in that to meet it a body must have purposes drawn exclusively from a statutory list of “charitable purposes”⁴⁴ and must provide “public benefit.”⁴⁵ The test is different from the English definition, however, in that the list of charitable purposes in the 2005 Act is by no means identical to the parallel list in the 2006 Act,⁴⁶ and in that the public benefit element requires OSCR to take an overview of the activities of the applicant body, and not merely to consider whether each of its purposes is individually for the public benefit as a matter of law.⁴⁷ A further difference is that the accumulated case law on “charity,” while it may have some value as an interpretive guide to the application of the charity test, has no binding status under the 2005 Act, whereas it is expressly preserved by the 2006 Act, though subject to adjustment, as part of the revised English definition.⁴⁸ More concretely, notable differences of detail between the charity test and the updated English definition are to be found in their treatment of sports organizations,⁴⁹ of organizations campaigning for changes in the law

1999 (SI 1999/678). An “index” of Scottish charities was improvised from the Inland Revenue’s records of bodies entitled to charitable tax relief: 1990 Act, s.1(1).

³⁹ 2005 Act, s.1. “OSCR” stands for “Office of the Scottish Charity Regulator.”

⁴⁰ 2005 Act, s.3. *See* 2005 Act, s.1(5) for the other general functions of OSCR; and generally Stuart Cross and Patrick Ford, *Greens Annotated Acts: Charities and Trustee Investment (Scotland) Act 2005* (Edinburgh, Thomson/W Green, 2006) (hereafter “Cross and Ford”), 6-8.

⁴¹ The Parliament, set up under the Scotland Act 1998, first sat in 1999.

⁴² Charities and Trustee Investment (Scotland) Act 2005, s.7.

⁴³ *See supra*, n. 35. Charitable tax relief at United Kingdom-level is granted on application to H M Revenue & Customs.

⁴⁴ 2005 Act, s.7(1)(a), (2).

⁴⁵ 2005 Act, ss.7(1)(b), and 8.

⁴⁶ *Cf.* 2005 Act, s.7(2) with Charities Act 2006, s.2(2).

⁴⁷ *Cf.* 2005 Act, s.7(1)(b) and 8 with Charities Act 2006, s.2(1)(b) and 3. For a full discussion of the English provisions *see* Peter Luxton, “A Three-part Invention: Public Benefit under the Charity Commission” (2009) 11(2) *Charity Law & Practice Review* 19-33.

⁴⁸ Charities Act 2006, ss.1, 2(5), 3 and 4; for the Scottish position *see* generally Cross and Ford, *supra* n. 40 at 24 -33.

⁴⁹ *Cf.* 2005 Act, s.7(2)(h) and 7(3)(c) with Charities Act 2006, ss.2(2)(h) and (3)(d).

or government policy,⁵⁰ and of organizations subject to a greater or lesser degree of ministerial control.⁵¹ These and other differences mean that a body which meets one test or definition may not necessarily meet the other.⁵²

OSCR enters in the Scottish charity register those bodies which apply for registration and meet the charity test.⁵³ In contrast to the position in England and Wales, a body only becomes a charity in Scotland on being entered in the register.⁵⁴ In contrast, again, with the position in England and Wales, it is not a requirement of registration with OSCR that a body has a pre-existing territorial connection with Scotland.⁵⁵ Registration is voluntary, but there are strong incentives to register in the foundational principle of the 2005 Act that only bodies entered in the register may represent themselves as charities in Scotland,⁵⁶ and in the subsidiary provision that only bodies entered in the register are entitled to automatic “charitable” relief from non-domestic rates.⁵⁷ A body which represents itself as a charity without being registered – unless it falls within the one exception to the foundational principle to be mentioned below – is subject to enforcement action by direction of OSCR or, on the application of OSCR, by order of the Court of Session.⁵⁸

The requirement to register in order to use the designation “charity” applies regardless of the size of the body in question: there are no equivalents of the exceptions and exemptions from registration found in the charities system in England and Wales.⁵⁹ A further distinctive feature of the new Scottish system is that in the event of a body being removed from the register – whether at its own request or because it no longer meets the charity test⁶⁰ – an “asset lock” applies, to the effect that on removal the body is bound to administer its whole pre-removal assets for its charitable purposes as recorded in the register immediately before removal, and to submit on an ongoing basis to a modified version of the normal compliance regime in respect of those assets.⁶¹

⁵⁰ Cf. 2005 Act s.7(4)(c) with *McGovern v Attorney-General* [1982] Ch 321, the force of which is preserved by Charities Act 2006, s.3(2).

⁵¹ Cf. 2005 Act, s.7(4)(b) with *Construction Training Board v Attorney-General* [1973] Ch 173. Doubts about the charitable status under the 2005 Act of Further Education colleges led the Scottish Ministers to adjust the establishing legislation for such institutions to remove the right of Ministers to close them without the consent of the governing body: see Further Education (Scotland) Act 1992 Modification Order 2008 (SSI 262/2008), made under 2005 Act, s.102(a). Such institutions have long been regarded as charitable for United Kingdom tax purposes.

⁵² For a fuller comparison of test and definition see Patrick Ford, “A statute of unintended consequences? The impact of the Charities and Trustee Investment (Scotland) Act 2005 on non-Scottish charities operating in Scotland” (2008) 59(2) NILQ 201-222 (hereafter “Ford, ‘A statute of unintended consequences’”), at 209-214.

⁵³ 2005 Act, s.3.

⁵⁴ 2005 Act, s.106.

⁵⁵ Cf. Charities Act 2006, s. 1(1): also *Gaudiya Mission, supra* n. 22.

⁵⁶ 2005 Act, s.13.

⁵⁷ Local Government (Financial Provisions etc) (Scotland) Act 1962, s.4 as amended by 2005 Act, s.104 and sched 4, para 2. Previously, charitable tax relief from non-domestic rates was granted by reference to the English definition in the same way as under United Kingdom-level taxation statutes.

⁵⁸ 2005 Act, ss.28, 31, 32 and 34.

⁵⁹ See section 2.1 above.

⁶⁰ 2005 Act, ss.18 and 30.

⁶¹ 2005 Act, s.19.

The normal compliance regime for bodies entered in the register as charities involves, in particular, keeping accounts and reporting annually to OSCR.⁶² To assist it in monitoring and enforcing the regime, OSCR has powers of investigation, and short-term powers of intervention of its own,⁶³ such as the power to suspend charity trustees.⁶⁴ OSCR may also apply to the Court of Session for exercise of the court's fuller powers of intervention,⁶⁵ such as power to remove charity trustees.⁶⁶ As in the case of England and Wales, there is an intermediate appeals tribunal, the Scottish Charities Appeals Panel, before which decisions of the regulator can be challenged without the expense of a full court action.⁶⁷

The 2005 Act also updates the control of fundraising in Scotland by provisions which apply, not only to charities in the sense of bodies registered with OSCR, but more broadly to "benevolent bodies," that is, bodies established for charitable, benevolent, or philanthropic purposes.⁶⁸ The controls deal, among other issues, with the relationship between benevolent bodies and professional fundraisers, with the prevention of unauthorized fundraising, and with collections of money or goods from the public.⁶⁹

3.2 Application to External Charities Operating in Scotland

There is one exception to the principle that no body may call itself a charity in Scotland unless it is registered with OSCR: by section 14 of the 2005 Act a body established and managed outside Scotland may refer to itself as a charity if entitled to do so in its jurisdiction of establishment, if it neither occupies land or premises in Scotland nor carries out activities in any office, shop, or similar premises in Scotland, and if when referring to itself as a charity it makes clear that it is established outside Scotland.

The Act envisages two options, therefore, for an "external charity" – a body established in a jurisdiction other than Scotland and entitled to call itself a charity there – which intends to carry out activities of any significance in Scotland.⁷⁰ First, an external charity may operate within the constraints of the section 14 exception by carrying out its activities in Scotland without the benefit of anything more than a minimal base in the territory. A body established as a charity in England and Wales could, for instance, mount a fundraising campaign from across the border

⁶² 2005 Act, s.44 and Charities Accounts (Scotland) Regulations 2006 (SSI 2008/218) as amended by Charities Accounts (Scotland) Amendment Regulations 2007 (SSI 2007/136).

⁶³ 2005 Act, ss.28, 31, 32.

⁶⁴ 2005 Act, 31(4).

⁶⁵ 2005 Act, s.34.

⁶⁶ 2005 Act, s.34(5)(c).

⁶⁷ 2005 Act, ss.75-78. The Scottish Government has proposed that the panel should be dissolved and its functions transferred elsewhere as part of a general simplification of public administration in Scotland.

⁶⁸ 2005 Act, s.79.

⁶⁹ 2005 Act, Part 2. Provisions for a revised regime of "public benevolent collections" to be overseen by local authorities (ss.84-92) are not yet in force and a similar but outdated regime under Civic Government (Scotland) Act 1982, s.119, still applies.

⁷⁰ OSCR regards the s.14 exception as covering bodies with "only an occasional connection" with Scotland that does not amount to a "significant operation": OSCR, *Guidance on Registration*, Section 2; see also Section 4.2.a.

electronically or by post without using premises in Scotland – provided that any references to charitable status refer to the jurisdiction in which it is established.

Second, an external charity may register with OSCR and become entitled to call itself a charity in Scotland in the same way as a body established in Scotland that registers with OSCR.⁷¹ This entitlement, which, as mentioned, would bring with it entitlement to “charitable” relief from non-domestic rates in Scotland, involves satisfying two potentially onerous requirements. The first is a requirement to meet the Scottish charity test as part of the registration process – a requirement which, in the case of English and Welsh charities in particular, may necessitate an alteration of the charity’s governing instrument because of the differences between the charity test and the English definition of charity.⁷² The second is a requirement of dual regulation: that is, of meeting the demands of the Scottish compliance regime as well as those of the charity’s home charities regime. Where the demands are different in detail, for instance in relation to references to charitable status on documents,⁷³ or to accounting and reporting,⁷⁴ dual compliance is likely to lead to additional if not double devotion of resources to compliance.⁷⁵

An external charity contemplating activity in Scotland under the banner of “charity” has, therefore, three clear options: to squeeze into the section 14 exception; to go the whole hog of registration with OSCR and dual compliance, in the knowledge that the asset lock will make opting out of the Scottish system much more difficult than opting into it;⁷⁶ or not to be active in Scotland after all.

In practice, of the external charities which have registered with OSCR so far, the vast majority have been charities established in England and Wales and registered with CCEW.⁷⁷ Most of these are large or very large charities by Scottish standards.⁷⁸ At least a proportion of these dual-registered charities have had to adjust their constitutions in order to meet the charity

⁷¹ On the face of it, the Act appears to allow for a third possibility, namely to operate in Scotland as a non-charity benevolent body. Such a body could fund-raise and confer benefit in Scotland but would have to avoid calling itself a charity there. No doubt there would be practical difficulties, but in any event OSCR does not regard this as a real option: OSCR, *Guidance on Registration*, Section 4.2.a.

⁷² See Charity Commission, *Guidance for English and Welsh charities that have been asked to amend their governing documents before they can register in Scotland* (London, Charity Commission, 2007).

⁷³ Cf. 2005 Act s.15 and Charities References in Documents (Scotland) Regulations 2007 (SSI 2007/203), as amended by Charities References in Documents (Scotland) Amendment Regulations 2009 (SSI 2008/58) with Charities Act 1993, ss.5, 67 and 68.

⁷⁴ See further, below.

⁷⁵ For other aspects of dual compliance likely to be irksome see Ford, “A statute of unintended consequences,” *supra* n. 52 at 205.

⁷⁶ See 2005 Act, s.19. Arguably the asset lock operates in the case of an external charity only over its Scottish assets: see Scotland Act 1998, s. 29(2)(a) and 101(2).

⁷⁷ See OSCR, *Monitoring of cross border charities: Proposals for consultation* (September 2008), 2, and table at 15. By February 2008 there were 530 cross-border charities registered with OSCR – see n. 4 *supra*.

⁷⁸ Of 450 cross-border charities registered with OSCR as at September 2008, 93% had an annual income in excess of £25,000 and 60% an income in excess of £1m. Of the 22,850 local charities registered with OSCR, 67% had an annual income of less than £25,000 and only 3% an income of over £1m. See OSCR, *Monitoring of cross border charities: Proposals for consultation* (September 2008), table at 15.

test,⁷⁹ but the principal concern otherwise has been dual compliance in the area of annual accounting and reporting.⁸⁰ OSCR, pursuing the strategic objective of reducing “the burden of regulation on charities wherever possible, with particular emphasis on reducing multiple reporting,” has recently consulted on a “modified reporting regime for cross border charities.”⁸¹ OSCR proposes to “place considerable reliance on the Charity Commission as a lead regulator,” with a view to avoiding duplication of monitoring material submitted to CCEW.⁸² OSCR’s proposals set out to mitigate, but because of the differing regulatory requirements cannot remove altogether, the burdens of dual compliance in accounting and reporting.⁸³

The 2005 Act contains further provision of significance to external charities in the form of authority to OSCR to coordinate with other regulators on both the sharing of information and cross-border enforcement. OSCR is expressly bound to cooperate with equivalent regulators, in the United Kingdom and elsewhere,⁸⁴ and is authorized to disclose information to those regulators in the exercise of its functions.⁸⁵ OSCR may also, on a reference from the CCEW, apply to the Court of Session for measures to protect movable property held in Scotland on behalf of a charity established in England and Wales where there is an allegation of misconduct in the administration of the charity.⁸⁶

4. ISSUES FOR EXTERNAL CHARITIES OPERATING IN NORTHERN IRELAND

4.1 Outline of the New Framework of Charity Law for Northern Ireland

The Charities Act (Northern Ireland) 2008 introduces a new regulatory framework for charities in Northern Ireland with the establishment of the Charity Commission for Northern Ireland (CCNI),⁸⁷ a new register of charities, the adoption of a statutory definition of charitable

⁷⁹ See OSCR, *OSCR Response to the Calman Commission* (February 2008), 4; also Ford, “A statute of unintended consequences,” *supra* n. 52 at 221, note 167.

⁸⁰ In particular, for small and medium-sized charities, the accounting requirements are in many respects more onerous under the Charities Accounts (Scotland) Regulations 2006 than under their equivalents in England and Wales. For example, in England and Wales, charities with an annual income of up to £25,000 are not obliged to have their accounts independently examined, or even to submit them to the CCEW, but these concessions do not apply in Scotland. Also, in England and Wales, the independent examiner (IE) only has to be professionally qualified if the charity’s income is over £250,000, but in Scotland a qualified IE is mandatory whenever “fully accrued accounts” are prepared, which is compulsory at an income of £100,000 and above. See further Appendix below.

⁸¹ OSCR, *Monitoring of cross border charities: Proposals for consultation* (September 2008), 3.

⁸² *Ibid.*

⁸³ OSCR’s proposals are in essence that a cross-border charity must submit (1) accounts which conform with the Scottish accounting regulations but which may be UK consolidated accounts without differentiation of Scottish activities; (2) an Annual Return Form which will be largely pre-populated with information already held by OSCR; and (3) an Information Return for Dual-Registration Charities which seeks to elicit financial and other data specific to the charity’s Scottish activities.

⁸⁴ 2005 Act, s.20.

⁸⁵ 2005 Act, ss.24 and 25.

⁸⁶ 2005 Act, s.36. Charities Act 1993, s.80, contains reciprocal provisions. See also section 2.2, above.

⁸⁷ The Northern Ireland Department of Social Development expects to establish the Charity Commission of Northern Ireland in April 2009 with the appointment of the first Charity Commissioners. See the Department’s draft timetable at http://www.dsdni.gov.uk/charities_draft_time_table.htm (last accessed March 20, 2009).

purposes (broadly reminiscent of the English statutory definition)⁸⁸ coupled with a public benefit test that draws inspiration from the Scottish test.⁸⁹ To be charitable under the 2008 Act, a body must fall within one of the twelve heads of charitable purpose set out in s. 2 and satisfy the public benefit test laid down in s. 3. Like Scotland, Northern Ireland has chosen to sever the link between the UK tax definition of “charitable purpose” (which continues to be governed by the 2006 Act and applies throughout the United Kingdom for tax purposes⁹⁰) and the controlling definition for the regulation of charities by developing its own parameters for “charitable purpose.” The result is a charity test that is similar but not identical to the 2006 Act definition.⁹¹

The 2008 Act requires every institution that is a charity under the law of Northern Ireland to be registered, without exception. Presence on the register provides a conclusive presumption that an institution is charitable.⁹² Once registered, a charity is required to file annual accounts with the CCNI within 10 months of the charity’s year end. In particular, the accounts of unincorporated charities with an annual income of over £100,000 require independent examination by a qualified person whereas an audit is required for those charities with an annual income in excess of £500,000.⁹³ All registered charities must also provide an Annual Report, detailing the charities’ activities for the previous year.

Responsibility for the regulatory oversight of charities shifts from the Department of Social Development to the CCNI which, apart from its role in maintaining the register,⁹⁴ will enjoy wide powers to investigate apparent misconduct in the administration of charities, to suspend or remove trustees,⁹⁵ freeze charitable assets,⁹⁶ and determine applications for public collection permits.⁹⁷ All of these powers are subject to the right of appeal to both the new Charity Tribunal for Northern Ireland and the High Court of Northern Ireland.⁹⁸

4.2 Application to External Charities Operating in Northern Ireland

Section 1 of the Charities Act (Northern Ireland) 2008 defines “charity” as limited to an institution that is established for charitable purposes only and falls subject to the control of the

⁸⁸ *C.f.* Charities Act (Northern Ireland) 2008, s.2 with 2006 Act, s. 2.

⁸⁹ *Cf.* 2008 Act, s. 3 with 2005 Act, s.8.

⁹⁰ 2006 Act ss. 80(5) and (6) – *see supra* n. 29 and n. 35.

⁹¹ For further discussion of the differences in the concept and scope of charitable purpose introduced by the 2008 Act, *see* Oonagh B. Breen, “Neighbouring perspectives: legal and practical implications of charity regulatory reform in Ireland and Northern Ireland” (2008) 59(2) *Northern Ireland Legal Quarterly* 223–43.

⁹² 2008 Act, s. 18. The Department of Social Development envisages the creation of the charities register by a commencement order in September 2009 with the first charity registrations occurring in April 2010 (*see* http://www.dsdni.gov.uk/charities_draft_time_table.htm).

⁹³ 2008 Act, ss. 64-65. Unincorporated charities with an annual income of less than £100,000 require external scrutiny from an independent person with the requisite skills. Charitable companies will continue to prepare their accounts in line with Part 15 of the Companies Act 2006 (c.46) – *see* 2008 Act, s. 68(5). *See* the Appendix for further details of the accounting arrangements under the 2008 Act.

⁹⁴ 2008 Act, Part 4, ss. 16-21.

⁹⁵ 2008 Act, s. 34.

⁹⁶ 2008 Act, s.33.

⁹⁷ 2008 Act, Part 13.

⁹⁸ 2008 Act, Part 3, ss. 12-15.

Court in the exercise of its jurisdiction with respect to charities. It is clear from the outset, therefore, that external charities that are not subject to the power of the High Court of Northern Ireland will not be subject to the provisions of the Act requiring charity registration⁹⁹ and the concomitant disclosure¹⁰⁰ and reporting requirements¹⁰¹ that flow from there. Section 1 finds its origins in section 1 of the English Charities Act 2006 and takes account of the prevailing jurisprudence relating to English courts' jurisdiction over external charities.¹⁰² It follows that a charity established under Irish, Scottish, or English law will not be a charity within the meaning of section 1 and will not therefore be eligible (or required) to register with the CCNI under section 16 of the Act.

It would be wrong to assume, however, that external charities are therefore to be left entirely unregulated in Northern Ireland. Section 167, which deals expressly with such entities, applies to any institution which is not a charity under the law of Northern Ireland but which operates for charitable purposes in or from Northern Ireland. These "s.167 institutions," although not required to register under section 16, nonetheless will be required to prepare financial and activity statements with regards to their Northern Ireland operations. The Department of Social Development can require the CCNI to keep a special register of such organizations and the Department will also have the power to apply or disapply any of the provisions of the 2008 Act to these organizations, as it sees fit. The only proviso governing all of the foregoing is that any Departmental order relating to the treatment of external charities must be laid before the Northern Ireland Assembly and be approved by resolution before it can be implemented.

Section 167 of the 2008 Act has no comparative provision amongst its English, Scottish, or Irish neighbors. In drafting this provision, Northern Ireland officials learnt from the experiences of their Scottish and English counterparts. The requirement in the 2005 Scottish Act that all charities operating in Scotland must register with OSCR resulted in some English charities having to amend their constitutions in order to do so.¹⁰³ Such amendments caused difficulties for the CCEW,¹⁰⁴ which resulted in its representations to Northern Ireland not to replicate this procedure. The underlying purpose of section 167 seems to be to recognize as "charitable" organizations that are already registered charities in Great Britain without querying their validity in this regard but still requiring them to meet Northern Ireland accountability requirements.¹⁰⁵

The practical effect of this provision will allow for organizations approved under the broader charitable purposes lists of another jurisdiction to be accepted as charitable in Northern Ireland even if such a charitable purpose would have been outside the scope of those that could

⁹⁹ 2008 Act, s. 16.

¹⁰⁰ 2008 Act, ss. 19 and 70.

¹⁰¹ 2008 Act, ss. 66 and 69.

¹⁰² See *Gaudiya Mission*, *supra* n. 22.

¹⁰³ See Charity Commission for England and Wales, *Guidance for English and Welsh charities that have been asked to amend their governing documents before they can register in Scotland*, available at <http://www.charity-commission.gov.uk/supportingcharities/oscrguide2.asp> (last accessed January 22, 2009).

¹⁰⁴ See n. 72 *supra*.

¹⁰⁵ Testimony of Mr. Seamus Murray, Department of Social Development, Committee for Social Development, Charities Bill, NORTHERN IRELAND ASSEMBLY HANSARD, February 28, 2008.

be approved by the CCNI if registration had first been sought in Northern Ireland. In this regard, there will be no need for such external charities to amend their governing instruments for recognition in Northern Ireland to occur. Although conceived of in the context of the United Kingdom and existing regional variations in definition of charitable purpose, it will prove difficult to limit the scope of this provision to charities registered in Great Britain, since Irish or, indeed, French or German charities, if operating in Northern Ireland, equally will fall outside the definition of “charity” in section 1 and will thus arise for consideration under section 167 too. Indications are that where states have rigorous charity regulation regimes in place, the NI Department of Social Development will direct the CCNI to recognize external charities from these states in a similar manner to those from Great Britain. In cases where a state does not have a comprehensive regulatory scheme in place for oversight of its domestic charities, section 167 gives the Department of Social Development freedom to be more demanding in the requirements that such external charities must satisfy before recognition is granted.

The full implications of section 167 for external charities are hard to tease out at present since the all-important detail remains to be spelt out by way of Departmental Order and regulations. Notwithstanding first impressions, the Charities Act (Northern Ireland) does not give external charities registered in another jurisdiction an unconditional passport to operate in Northern Ireland. Section 167 institutions will be required to register on a separate register – described in Committee stage as a “parallel register” – and obliged to report and make financial returns to the CCNI in order to fulfil the public accountability aspect of that legislation.¹⁰⁶ The Northern Ireland accounting requirements are exacting insofar as it is clear on the face of the legislation¹⁰⁷ that the CCNI is interested solely in financial accounts and performance reports relating to Northern Ireland activities. As noted elsewhere, the legislation of other jurisdictions may be implicitly construed to the same effect but they lack the clarity inherent in section 167 of the Charities Act (Northern Ireland) 2008.¹⁰⁸

A further consequence of Northern Ireland’s direct approach to dealing with external charities appears to be that there will be no *de minimis* exemption that will enable these bodies to “opt out” of registration and accountability. Section 167 leaves no escape door for an external charity to carry out activities in or from Northern Ireland and not be registered with the CCNI. In this respect, Irish charities that operate on an all-island basis would thus be required to register as s.167 institutions even if only engaged in ad hoc charity fundraising ventures north of the border. Fundraising, service provision, and physical presence are all likely to require registration. Grant-making by external charities, however, may be possible without a separate registration required.

Section 167 gives the NI Department of Social Development some leeway to set lower levels of financial reporting for external charities that already file full accounts in another state and the higher audit thresholds that apply in Northern Ireland may relieve some Irish cross-border charities of the need for audited accounts.¹⁰⁹ Yet challenges will exist for external

¹⁰⁶ *Ibid.*

¹⁰⁷ 2008 Act, s. 167(3).

¹⁰⁸ Ireland: *see* n. 147 *infra* and accompanying text; Scotland: *see* Ford, *supra* n. 52.

¹⁰⁹ 2008 Act, s.65.

charities since separate accounts for Northern Ireland operations are required (a factor likely to impact Irish charities operating on a cross-border basis).¹¹⁰

In terms of broader international cooperative powers, section 24 of the Charities Act (Northern Ireland) 2008 provides a right of disclosure by or to the CCNI that extends to public bodies beyond the territory of the United Kingdom.¹¹¹ The definition of “public body” is not limited to other charity regulators but could encompass the police or revenue authorities in Ireland or further afield in an appropriate case. As in England, the purpose of disclosure is stated as being twofold: a) for any purpose connected with the exercise of the Commission’s functions or b) to enable or assist the public body or officeholder to exercise any functions. Whereas the latter rationale will probably arise with a request initiated by another public body, the first rationale might occur in a situation in which the CCNI needs to give information to a public body to enable it to assist the CCNI in its inquiries. In common with the English Act 2006, there is no general provision in the Charities Act (Northern Ireland) expressly providing for cooperation between the CCNI and other public bodies or officeholders, whether based in Northern Ireland or outside of the UK.¹¹² This omission may be an oversight on the part of the Northern Ireland administration, which borrowed heavily from the English legislation. The latter was unlikely to have an external cooperation provision in its 2006 Act given the vacuum in which the Charity Commission for England and Wales has operated for many years – up until recently, neighboring jurisdictions have not had modern charity regulatory regimes much less comparative charity regulators with which the Charity Commission could conceivably have cooperated.

The only provision relating to cross-border cooperation in the Charities Act (Northern Ireland) is to be found in section 56 and it is limited to cooperation within the UK.¹¹³ The CCNI may, on a reference from either OSCR or the CCEW, apply to the High Court for Northern Ireland for measures to protect movable property held in Northern Ireland on behalf of a charity established in England and Wales or Scotland where there is an allegation of misconduct in the administration of the charity.¹¹⁴ This generosity of asset protection does not extend to charities established in the Republic of Ireland.¹¹⁵ Neither Scotland nor England and Wales affords a

¹¹⁰ Most of the thresholds in ss. 65-66 of the Northern Ireland Act were originally the same as for England and Wales, but are now considerably lower as a result of the increased thresholds in E&W from April 2009 – see table II in the Appendix below. But there are also more fundamental differences since, unlike E&W, there is no lower limit for charity registration, nor is there a level below which a charity is exempt from any external scrutiny of its accounts – so in these respects the Northern Ireland requirements are closer to those in Scotland.

¹¹¹ 2008 Act, s. 24(1).

¹¹² By contrast, s.20 of the Charities Trustee and Investment (Scotland) Act, 2005 and ss. 33 & 34 of the Irish Charities Act 2009 provide for such external regulatory cooperation.

¹¹³ In this regard, s. 56 of the Charities Act (Northern Ireland) 2008 can be compared with s.36 of the Charities Trustee and Investment (Scotland) Act 2005 and with s.80 of the English Charities Act 1993.

¹¹⁴ 2008 Act, s. 56.

¹¹⁵ Thus, if an Irish charity, guilty of misconduct in the administration of its assets, were to move those assets to Northern Ireland, the CRA or the affected claimants would be forced to make out a civil case for a Mareva injunction, relying on the Brussels Convention to secure enforcement. The Brussels Convention, officially the “Convention on the Enforcement of Judgments in Civil and Commercial Matters,” agreed in 1968 by the member states of the EU, has the goal of increasing economic efficiency and promoting the single market by harmonizing the rules on jurisdiction and preventing parallel litigation. The Convention, as now interpreted by Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil

similar reciprocity of asset protection to Northern Ireland in its charity legislation.¹¹⁶ This oversight most likely is due to the order of the statutes' respective enactment but the absence of full reciprocity is nonetheless unfortunate.

5. ISSUES FOR EXTERNAL CHARITIES OPERATING IN THE REPUBLIC OF IRELAND

5.1 The New Legislative Framework of Charity Law in Ireland

The Irish Charities Act, 2009 introduces a new regulatory framework for charities in Ireland, thereby amending the existing Charities Acts 1961-1973.¹¹⁷ The Act provides for a new statutory definition of "charitable purpose" that is similar but not identical to those statutory definitions currently in place in Scotland, England and Wales, and Northern Ireland.¹¹⁸ A register of charities is established under the Act¹¹⁹ and registered charities are subject to certain annual reporting requirements¹²⁰ as well as to the supervisory oversight of a new statutory regulator, the Charities Regulatory Authority (hereafter the "CRA"). The CRA takes over both the protective responsibilities of the Attorney General¹²¹ and the supportive role of the Commissioners of Charitable Bequests and Donations towards charities.¹²² For the first time in Ireland, the new regulator will monitor charities from a charity governance perspective as distinct from purely taxation or company law perspectives. The Irish Charities Act provides that the functions of the CRA will include the protection of charitable assets and the facilitation of the better administration of charitable organizations and trusts.¹²³

To this end, all organizations that wish to call themselves charities, regardless of size or organizational form, will be required to register with the CRA.¹²⁴ This registration requirement extends to external charities established outside but active within the State.¹²⁵ Subject to a limited exception for external charities, discussed below, it will be an offense to call oneself a charity and not be registered.¹²⁶

and commercial matters governs the circumstances in which preliminary orders, such as freezing orders can be granted in signatory jurisdictions.

¹¹⁶ See Charities Trustee and Investment (Scotland) Act 2005, s. 36 and English Charities Act 1993, s. 80.

¹¹⁷ Charities Act, 2009 (No. 6 of 2009).

¹¹⁸ Cf. 2009 Act, s.3 with 2005 Act, s.7(2); 2006 Act, s.2; and 2008 Act, s.2.

¹¹⁹ 2009 Act, s. 39.

¹²⁰ 2009 Act, ss. 48 & 49 (annual statement of accounts) and s. 52 (annual reports).

¹²¹ 2009 Act, s. 38 (transfer of functions of Attorney General to CRA).

¹²² 2009 Act, Part 6 (dissolution of the Commissioners of Charitable Donations and Bequests and transfer of functions to the CRA).

¹²³ 2009 Act, s. 14.

¹²⁴ 2009 Act, s. 39(3) & (4). Charities that qualified for tax relief prior to the enactment of the Charities Act will be deemed registered under s. 40.

¹²⁵ 2009 Act, s. 39(5). S. 39(5) [the 'Stauffer clause'] gives effect to the European Court of Justice's decision in Case C-386/04 *Centro di Musicologia Walter Stauffer v. Finanzamt Munchen fur Körperschaften* [2006] ECR I-8203, which prohibits a Member State from discriminating against an EEA-established charity on the grounds that its principal place of business is in another EEA member state.

¹²⁶ 2009 Act, s.41.

Traditionally, the availability of tax relief and the general credibility and confidence that the donating public places in charities were reasons said to motivate organizations to seek “charitable status” and therefore to buy into a regulatory regime. The label “charitable status” is used advisedly here since until the enactment of the 2009 Act, it signified nothing more in Ireland than that Revenue Commissioners had granted the organization tax-exempt status for charitable purposes. Registration with the CRA will not, however, guarantee an organization tax-exempt status since the Charities Act decouples the awarding of tax exemption (which will remain within the sole ambit of Revenue) from that of charitable status (now to be determined by the CRA).¹²⁷ In this regard, the Irish regime, when operational, will resemble the Scottish position where tax-exempt status and charitable status are also severed.¹²⁸

With regards to the public confidence that flows from the bestowal of charitable status on an entity, prior to the enactment of the 2009 Act there was little in Ireland’s regulatory regime to justify the belief that a tax-exempt charity was a well-governed charity *per se*. The Charities Act will bring greater credence to this claim of faith since only registered charities will be entitled to use the charity label in future.¹²⁹ The “feel good” factor associated with registered charitable status will be shored up by obligations on registered charities to account annually for their performance and their financial activities, thus giving the moniker “registered charity” a depth and meaning that in the past it has lacked.¹³⁰ However, beyond the right to use the charity label, registration with the CRA *per se* will bestow few other rights.

The downside to registration for charities will flow from the concomitant duties of registered charities that buy into the statutory regime. All registered charities will have disclosure and reporting requirements. The Charities Register will be open to public scrutiny and registered charities will be required to file an annual report with the CRA detailing their performance¹³¹ and to maintain proper books of account.¹³² With the exception of charities having a gross income or total expenditure of less than €10,000,¹³³ all charities are required to prepare and file their annual

¹²⁷ 2009 Act, s. 7. In this regard, s.7(2) expressly provides that in the exercise of its tax functions, the Revenue Commissioners shall not be bound by a determination of the CRA as to whether a charitable purpose is for the public benefit or not.

¹²⁸ See n. 41 *supra* and accompanying text. In terms of operation, it is likely that the CRA will enter into a memorandum of understanding with the Irish Revenue Commissioners regarding the respective approaches of these agencies to the determination of charitable purposes under s.33(1)(c) 2009 Act. *Cf.* Memorandum of Understanding between The Office of The Scottish Charity Regulator and HM Revenue & Customs (Charities) (2006).

¹²⁹ 2009 Act, s. 46(2). Subject to the exception set down in s. 46(6), it will be an offense to hold an organization out as a charity and not be registered with the CRA.

¹³⁰ To this end, s.46(2) of the Act makes it an offense for a body (other than a registered charity) to describe itself or its activities in any advert, promotion, or notice in such terms as would cause members of the public to reasonably believe that it is a charitable organization. It is intended that this provision will curtail the nefarious activities of certain commercial charity bag clothes collectors that masquerade as charities in their collection activities.

¹³¹ 2009 Act, s. 52(1).

¹³² 2009 Act, s. 47. *Cf.* s.47(11) exempting charitable companies from this requirement.

¹³³ 2009 Act, s.48 (6) & s. 52(4). These provisions also exempt charitable companies, education bodies, and designated education centers from the requirement to file with the CRA but in each of these cases those bodies are subject to existing filing requirements with other regulators. It follows that the combined effect of ss. 48 and 52 is that charities with income/expenditure of less than €10,000 will not be required to expose their accounts to regular scrutiny although they will still be required to file an annual report with the CRA under s.52(1).

returns with the CRA (in the case of unincorporated charities) or the Companies Registration Office (in the case of incorporated charities).¹³⁴ Charities will also find themselves under an onus to participate in a proposed non-statutory fundraising regulation regime since its failure would trigger legislative intervention and the imposition of a statutory framework.¹³⁵ Registration will bring charities under the jurisdiction of the CRA, which will have the power to carry out inspections in cases of suspected charity mismanagement or fraud and whose permission must be sought on matters ranging from cy près applications and dissolution more generally to any other changes to an organization's declared charitable purposes or its charity name.

5.2 Issues for External Charities Operating in Ireland

If the downside of “buying into” the Irish regulatory regime appears untenable for external charities that are already subject to regulatory regimes in their home countries, there does remain a limited “opt-out” possibility. Certain external charities can have a presence in Ireland while holding themselves out to be charities and yet avoid the requirement to register with the CRA and all of the associated statutory obligations. According to section 46(6), an unregistered charity that is publicly described as a charity in Ireland will not commit an offense under Irish law if it satisfies the following conditions:

- it is established under the law of a place other than the State¹³⁶ and under that law it is entitled to be described as a charity;
- its center of management and control is outside the State;
- it does not occupy any land in the State or carry out any activities in the State; and
- the advertisement or promotional literature, containing the description of the external charity, is accompanied by a statement as to its place of establishment.

A literal reading of the section would imply that it will have quite a narrow application and the provision drew little comment at Committee Stage in the Dáil (the Irish Lower House of Parliament), perhaps precisely for this reason.¹³⁷ An external charity, properly recognized under the laws of its home country, that does nothing in the State will be able to declare its charitable status without incurring an obligation to register. This constitutes the lowest form of mutual recognition available. One could conceive that whereas an external charity with Irish property investments in its portfolio could take advantage of section 46(6), an external charity with a toehold (in the form of an office site or shop) in the State or one that carried out “any activities,” whether in the nature of fundraising, grant-making, or service provision – no matter how infrequent or minimal – would be required to register.

¹³⁴ 2009 Act, s. 48(1). Under s. 49 of the Act, incorporated charities will continue to make their returns to the Companies Registration Office, which Office upon receipt of notification from the CRA will give a copy of those returns to the CRA, thereby avoiding dual filing requirements in respect of returns by incorporated charities. *See further* the Appendix below.

¹³⁵ 2009 Act, s.97. For details on the proposed non-statutory fundraising regulation regime *see* Irish Charities Tax Research Ltd, Final Report on the Regulation of Fundraising by Charities through Legislation and Codes of Practice (Dublin, May 2008) and Oonagh B. Breen, “Regulating Charitable Solicitation Practices– The Search For A Hybrid Solution” (2009) 25(1) *Financial Accountability & Management*, 115-143.

¹³⁶ *I.e.*, the Republic of Ireland.

¹³⁷ Irish Charities Bill 2007, Committee Stage, Dáil Debs, January 22, 2008.

The origins of section 46(6), as first set out in Head 53 of the Irish General Scheme of Bill in 2006, can be traced to section 14 of the Charities and Trustee Investment (Scotland) Act 2005.¹³⁸ Although no longer a verbatim version of s. 14 (reference to the location of the activities has been removed entirely), s. 46(6) still follows its basic structure. From its inception the Scottish provision has been construed as embodying a *de minimis* threshold with regard to activity. Whereas simple occupation (as opposed to mere ownership) of property in Scotland requires a charity to register with OSCR, significant activity is necessary to trigger a need for registration. This approach has been expressed both in policy memoranda preceding the Scottish Act and in subsequent guidelines from the Office of the Scottish Charity Regulator (OSCR) upon the Act's implementation.¹³⁹ In reviewing the extent of an organization's activities or operations in Scotland, OSCR focuses on the frequency of the activities, their significance with regard to activities carried out by the charity elsewhere, and the overall significance of the impact of those activities.

Neither the Explanatory Memorandum to the Irish Bill nor the parliamentary hearings on the Charities Bill gave any indication as to whether a strict literal interpretation (eschewing a *de minimis* approach) or a purposive interpretation (which would allow for a *de minimis* approach) will be adopted in relation to section 46(6). It is thus unclear, for instance, whether a Northern Ireland registered charity that holds a one-off fundraising event in Ireland will be obliged to register under s. 39 or will be exempt under s.46(6), or whether non-registration will necessarily grant external charities immunity from the investigative powers of the CRA, which are not limited to registered charities.¹⁴⁰

The options for external charities which have, or would like to have, a presence in Ireland and which fall outside the opt-out provisions of section 46(6) are two-fold: either to operate as a nonprofit organization without charitable status in Ireland or to register with the CRA. The former will be at no disadvantage to registered charities when it comes to applying for a public collections permit¹⁴¹ and indeed conceivably could apply for charitable tax-exempt status from Revenue, which currently is not dependent upon prior registration with the CRA.¹⁴² If, however, registered charitable status is the preferred option, an external charity may still experience a number of difficulties in achieving that status under Irish law.

¹³⁸ See section 3.2 above.

¹³⁹ See Scottish Parliament Information Centre (SPICe) Briefing 05/05: *Charities and Trustee Investment (Scotland) Bill: Regulation and Governance Issues* (January 21, 2005); Office of the Scottish Charity Regulator, *Guidelines to English and Welsh Charities on Registering in Scotland* (2006) at 4.1 ("The purpose of section 14 of the CTI(S) Act 2005 is to ensure that all charities with *significant* operations in Scotland register with OSCR.") [emphasis added]. See also Ford, *supra* n. 52.

¹⁴⁰ 2009 Act, s. 64, read in conjunction with s. 2.

¹⁴¹ The Irish Charities Act 2009 only regulates public collections for charitable purposes and not for benevolent or nonprofit purposes and thus is narrower than the Charities Act (Northern Ireland) 2008, which does cover such latter types of fundraising. The implications of the Irish position is that nonprofit organizations wishing to fundraise will continue to be governed by the earlier Street and House to House Collections Act, 1962 and will fall outside the proposed non-statutory fundraising codes of conduct. On a related note, gaming and lotteries also will fall outside the remit of the Irish Charities Act 2009 so that a charity engaged in the street selling of scratch cards would appear not to be regulated by the 2009 Act either.

¹⁴² It is likely that prior registration with the CRA may in future become a precondition for applying to the Revenue Commissioners for charitable tax exempt status. In this regard such registration could be seen as a necessary but not sufficient condition for tax exemption – see further 2009 Act, s.7.

The first difficulty concerns the types of charitable purposes that the CRA will recognize for the purposes of registration. The Irish statutory list of charitable purposes is considerably narrower than the statutory lists in Scotland, England and Wales, and Northern Ireland.¹⁴³ In contrast to neighboring jurisdictions, the Irish list of charitable purposes entirely omits reference to the advancement of human rights (found in all versions of the UK legislation), to the promotion of the armed forces (found in the English Act) and to amateur sport or recreational charities (again found in all the UK legislative versions) as acceptable charitable purposes.

In some specific areas the Irish wording, while similar, is still narrower than neighboring statutes. In this regard, the Irish reference to the advancement of the environment is limited to “the natural environment,” thereby excluding the built environment. Similarly, the concept of religion retains its common law meaning in Ireland, excluding reference to faiths that have no belief in a god at all (unlike the UK, where a religion with no god now can be charitable).¹⁴⁴ In the absence of an equivalent provision to Northern Ireland’s section 167, external charities active in Ireland whose purposes encompass any of these broader headings may need to revise their governing documents prior to registration in order to comply with Irish charity law. Any such revisions may require the consent of existing charity trustees and other charity regulators with whom the organization is already registered.¹⁴⁵

Once registered, an external charity will be required to file annual accounts and an annual report on its activities with the CRA.¹⁴⁶ The legislation is silent on whether registered external charities will be required to file accounts relating to their global operations or just accounts relevant to their Irish activities and operations carried out within the State.¹⁴⁷ Even assuming that the relevant accounts will relate only to Irish activities, it is worth bearing in mind that the Irish Charities Act imposes lower audit thresholds than its neighbors, which once exceeded will require an external charity to submit audited accounts to the CRA.¹⁴⁸ The specifics of the annual reports will be determined by Ministerial regulation¹⁴⁹ and so there is thus room for further variation in these requirements from those of neighboring jurisdictions. This differential will be

¹⁴³ Cf. Irish Charities Act 2009, s.3 with English Charities Act 2006, s.2; Charities and Trustee Investment (Scotland) Act, 2005, s.7; and Charities Act (Northern Ireland) 2008, s.2.

¹⁴⁴ See s.7 (2A)(e) Charities and Trustee Investment (Scotland) Act, 2005; s.2(3)(a)(i) English Charities Act 2006; and s. 2(3)(a)(i) Charities Act (Northern Ireland) 2008.

¹⁴⁵ See s. 16(2) Charities and Trustee Investment (Scotland) Act, 2005 (requiring OSCR’s consent for any constitutional amendments relating to a charity’s charitable purposes); see also s. 31 English Charities Act 2006, amending s. 64(2) Charities Act 1993 (Charity Commission consent required to changes in a charitable companies memo and arts).

¹⁴⁶ See further Appendix, below.

¹⁴⁷ 2009 Act, s.47(1). Presumably, regulations will be made under s. 48(1) detailing the nature of the accounts required. Cf. s. 167 of the Charities Act (Northern Ireland) 2008, which makes specific reference to the regional nature of the accounts to be filed.

¹⁴⁸ See further the Appendix, below.

¹⁴⁹ 2009 Act, s. 52(1). See further the Appendix, below.

particularly troublesome for Northern Ireland charities that operate on an all-island basis and that are required to register with the CRA.¹⁵⁰

In light of the limited exemption from registration, the differences in definition of charitable purposes, and the different reporting requirements, one might be forgiven for thinking that the drafters of the Irish Charities Act looked no further than their own borders when it came to facilitating charity practices. And yet other provisions of the Act indicate that this is not the case. Three sections are worthy of note in this regard. Section 28(3) empowers the CRA to disclose information obtained in the performance of its functions to relevant foreign regulators when it suspects the commission of an offense under the law of another state. Section 33 enables the CRA to enter into arrangements with both domestic and foreign regulators.¹⁵¹ Such arrangements may include the facilitation of administrative cooperation in the regulation of charities, the avoidance of unnecessary duplication of regulatory activities, and ensuring, “as far as practicable” consistency between decisions made, measures taken, or determinations regarding the regulation of charities by the CRA and other relevant regulator. Section 33 is a broad section insofar as the definition of regulator is not limited to charity regulators; the definition of relevant foreign regulator expressly covers “a body, or holder of an office, in whom functions are vested under the law of [another] state . . . relating to the regulation of activities or persons in that state for any purpose. . . .”¹⁵²

Finally section 34, headed “Administrative cooperation with foreign statutory bodies on law enforcement matters” focuses specifically on the relationship of the CRA with its charity regulator counterparts in other jurisdictions.¹⁵³ It allows for the conclusion of arrangements between the CRA and other charity regulators relating to both information disclosure (presumably in situations falling short of the suspected commission of an offense, which are already covered by s.28) and to the provision of assistance aimed at facilitating the other regulator in the performance of its functions.¹⁵⁴ Whereas s.34 arrangements require advance Ministerial approval, s.33 arrangements, which are expressed in subsection (2) to be non-binding in nature, merely must be notified to the relevant Minister.

6. INFORMAL COOPERATION BETWEEN CHARITY REGULATORS

The differences between the four regimes discussed above and the complexities of cross-border charity regulation may be mitigated to some extent by arrangements for informal cooperation. These include the *UK and Ireland Charity Regulators Forum* and the *North-South Taskforce on Fundraising Regulation*.

¹⁵⁰ See the minutes of the Meeting of the Ireland and UK Charity Regulators Forum, March 2007, recognizing these likely difficulties and discussing the need to consider issues relating to disaggregated account information and separate performance report information requirements for cross-border charities.

¹⁵¹ See 2009 Act, s. 33 (6)(b) which specifically makes reference to the inclusion of foreign statutory bodies in the definition of “relevant regulator.”

¹⁵² *Ibid.*

¹⁵³ 2009 Act, s. 34(6) (providing “In this section “foreign statutory body” means a person prescribed by regulations made by the Minister, in whom functions relating to charitable organizations or charitable trusts are vested under the law of a state other than the State.”)

¹⁵⁴ 2009 Act, s. 34 (1).

The former is a non-statutory forum, established in 2006, that meets on average three times a year and comprises officials from the Charity Commission for England and Wales, OSCR and, pending the establishment of the CCNI and CRA, Irish and Northern Ireland Departmental officials responsible for charity regulation. The forum aims to establish good working relations between the various charity regulators that will lead to a sharing of information and best practice and encourage greater consistency in regulatory practices and decisions while respecting the different legislative frameworks within which each regulator works.

The latter taskforce forms part of Ireland's review of charitable fundraising regulation. To progress the objective of employing non-statutory fundraising regulation the Irish Department of Community, Rural and Gaeltacht Affairs entered an agreement with a nonprofit think-tank (Irish Charities Tax Research Ltd) to carry out research and make recommendations on how the operational aspects of charitable fundraising can be effectively regulated through Codes of Good Practice. As part of this process, the North-South Task Force on Fundraising Regulation was established in 2006 comprising officials from Northern Ireland's Department of Social Development, representatives of the Northern Ireland Council for Voluntary Action (NICVA), the UK Institute of Fundraising and Irish charities along with fundraising and legal representatives familiar with both legal systems. The taskforce considered the feasibility of using similar fundraising regulation practices on an all-island basis, thereby lightening the regulatory burden on charities from each other's home jurisdiction that choose to fundraise across the border. ICTR's final report *Regulation of Fundraising by charities through legislation and codes of practice* was published in May 2008 and is currently under consideration by the Northern Ireland Department of Social Development.¹⁵⁵

Each of the four jurisdictions also provides a legal basis for the respective charity regulators to enter into memoranda of understanding with each other.¹⁵⁶ These memoranda may provide a useful mechanism for embedding any future informal agreements reached by the regulators through the Regulators Forum. One memorandum currently exists between OSCR and the CCEW. Originally signed by the regulators in May 2005, the memorandum was revised in 2007 to reflect the transition of OSCR from an executive agency to a statutory body and enactment of the Charities Act 2006. The terms of the understanding make specific reference to the need to minimize the burden of dual regulation on cross-border charities.¹⁵⁷ To this end, the memorandum highlights crucial areas for operational liaison between OSCR and the CCEW and mandates that the regulators should meet twice yearly to discuss cross-border related matters, either as part of the Charity Regulators Forum or separately there from.¹⁵⁸

¹⁵⁵ *See supra* n.135.

¹⁵⁶ The legal bases are to be found in 2005 Act, s. 24(1); 1993 Act, ss. 10 to 10C (as inserted by the Charities Act 2006, par. 104 of Schedule 8); 2008 Act, s.24 (1) and 2009 Act, s.33.

¹⁵⁷ Memorandum of Understanding between the Office of The Scottish Charity Regulator and The Charity Commission (March, 2007) at par. 1.1, available from <http://www.oscr.org.uk/PublicationItem.aspx?id=66d891da-e0bd-4cb1-9865-011b3da894c1>.

¹⁵⁸ *Ibid.*, at paras 5.1 & 5.2.

7. EXTERNAL CHARITIES – FOUR APPROACHES ASSESSED

7.1 Provisional assessment

As we have seen, Ireland and the three jurisdictions of the United Kingdom will shortly each have in place a sophisticated system for the regulation of charities. The system for England and Wales is long-established, though recently revamped, and is unmistakably the model for the other three – the system operative in Scotland since 2006 and the systems for which legislative provision has very recently been finalized in Northern Ireland and Ireland. There will shortly, therefore, be four parallel charities regulation systems in force in the four neighboring jurisdictions. In practice, there will be some organizations established as charities in one of the four jurisdictions as their “home” jurisdiction, which seek to be active, whether in raising funds from the public or in conferring benefit on the public, in all three of the other jurisdictions, and many more which seek to be active in at least one of the other three. There will also be organizations established as charities outside the four jurisdictions that seek to be active in one or more of them.¹⁵⁹ Each of the four systems approaches this phenomenon differently – the phenomenon that a charity established outside the jurisdiction in question, an external charity, may seek to be active as a “charity” within the jurisdiction. The purpose of this section of the article is to examine what the existence of these four approaches is likely to mean for organizations seeking to operate as external charities in one or more of the four jurisdictions, and to draw out from the examination a provisional assessment of the four approaches, taken together.

7.2 Overview of four systems

It may be helpful, as a preliminary, to offer a brief overview of the four charities systems described in previous sections as they will be when fully in force. As we have seen, the main features of the four systems are similar. Each has a definition, or “test,” of what makes a particular organization a charity and each has a registrar-regulator, responsible both for registering charities and for administering what may be described as a “compliance regime.” In each jurisdiction the compliance regime provides for charities, once registered,¹⁶⁰ keeping annual accounts and reporting to the regulator on their stewardship in fulfilling their objects,¹⁶¹ as well as submitting to a system of monitoring (intended to ensure that their stewardship is satisfactory), of investigation (where there are suspicions that a charity’s stewardship has fallen short of the required standard), and of enforcement (for instance, by removal from involvement with a charity of the persons responsible for an established failure of stewardship). In each jurisdiction, too, there are controls on fundraising. These are not, strictly speaking, in any of the four jurisdictions, part of the charities regulation system as such, since, while they regulate fundraising by charities, they control fundraising by a much wider range of organizations than charities registered with the regulator.

The main features of each of the four charities systems are similar, therefore, but there are many differences of detail. For example, the specifics of the definition or test of charity, and of the various other criteria of registration, differ from jurisdiction to jurisdiction, as do the

¹⁵⁹ For examples see *Gaudiya Mission supra* n. 22 (India); *Camille and Henry Dreyfus Foundation Inc v Inland Revenue Commissioners* [1956] AC 39 (New York State, USA).

¹⁶⁰ In England and Wales not all charities are required to register: see section 2.1 above.

¹⁶¹ See Appendix below.

accounting and reporting requirements. Such differences mean that an organization registered as a charity in one jurisdiction may not be eligible for registration in another and that reports and accounts which satisfy the compliance regime in one system may not satisfy the equivalent regimes elsewhere.

7.3 Overview of four approaches to external charities

If the registration and reporting requirements are different in detail across the four jurisdictions, so also is the treatment of external charities. By way of overview, the key elements in each jurisdiction's approach to external charities can be summarized as follows.

The focus of the treatment of external charities in England and Wales (intended or unintended, since the key provisions pre-date the development of charities regulation in the three neighboring jurisdictions) is on the protection of donors.¹⁶² An organization established as a charity outside England and Wales may raise funds within the jurisdiction, provided it abides by the fundraising controls applicable to local organizations, and provided in particular that no claim is made on its behalf that it is a "registered charity," that is, as charity registered with the CCEW. There is a criminal sanction against any person soliciting funds in association with a false claim that an organization is a "registered charity" in this sense. The effect is that donors in England and Wales may give to an organization which claims to be a registered charity in the knowledge that it is registered with the CCEW and subject to the CCEW's compliance regime. Otherwise, the system gives no guarantees in respect of an organization claiming to be a charity – whether local or external – and donors must give at their own risk.

A charity external to England and Wales is not, therefore, under any obligation to register – indeed will not normally be eligible to register¹⁶³ – with the CCEW, and will not be subject to CCEW's compliance regime, yet may call itself a "charity," but not a "registered charity," when fundraising within the jurisdiction. So far as the beneficiaries of external charities are concerned, the system in England and Wales offers minimal protection since external charities will not (normally) be subject to the CCEW's jurisdiction. Beneficiaries or donors who may have a complaint against an external charity must, in principle, refer it to the authorities of the charity's home jurisdiction.¹⁶⁴ The charities system in England and Wales does not, in other words, assert jurisdiction over external charities, but defers to the authorities of the relevant territories of establishment. The justification for this approach lies in the practical difficulties faced by the authorities in England and Wales in enforcing the domestic compliance regime against organizations based outside the jurisdiction.¹⁶⁵ There is, however, some (limited) provision for cooperation by the CCEW with other regulators, both by way of sharing information and taking enforcement action, as outlined in section 2.2 above.

¹⁶² See generally section 2.2 above.

¹⁶³ Because not "subject to the control of the High Court in the exercise of its jurisdiction with respect to charities": see Charities Act 2006, s. 1(1) and *Gaudiya Mission supra* n. 22, interpreting the equivalent provision in the Charities Act 1993. Exceptional circumstances can, however, be imagined in which a charity established under the law of another jurisdiction is sufficiently subject to the control of the High Court in the exercise of its charities jurisdiction to be eligible for registration (and obliged to register) with the CCEW, for instance where all the charity trustees are resident in England and Wales.

¹⁶⁴ The principle is explored in *Gaudiya Mission supra* n. 22. See in particular remarks of Mummery LJ at 352, citing Lord Brougham in *Mayor of Lyon v East India Co* (1836) 1 Moo PC 175, 297-298.

¹⁶⁵ See Mummery L.J. in *Gaudiya Mission supra* n. 22 at 350-352.

The Scottish system, on the other hand, seeks to protect the interests of both donors to and beneficiaries of charities external to Scotland.¹⁶⁶ A charity external to Scotland may raise funds within the jurisdiction provided it abides by the fundraising controls applicable to local organizations, but it must make no claim to be a “charity” when fundraising in Scotland unless either it is registered with OSCR and submits itself to OSCR’s compliance regime, or falls within the 2005 Act’s section 14 exception by virtue of carrying out no significant activities in the jurisdiction and having only a minimal territorial foothold there. An organization that claims to be a charity in Scotland without being registered or fitting within the section 14 exception is subject to enforcement action by direction of OSCR or in the Scottish civil courts.¹⁶⁷ These restrictions on the use by external charities of the charity label are not, however, confined to the context of fundraising. They apply in all situations, including the situation in which an external charity raises no funds in Scotland but only confers benefit. It should perhaps be emphasized that, in contrast to the arrangements in England and Wales, the restrictions govern the use of the word “charity” pure and simple, not merely the use of the term “registered charity.”

In principle, therefore, both donors and beneficiaries in Scotland may deal with any body claiming to be a charity in Scotland in the knowledge that it is registered with OSCR and subject to the Scottish compliance regime. In short, the Scottish authorities assert jurisdiction over external charities that wish to call themselves charities and do not fit within the section 14 exception, by requiring that they register in Scotland in the same way as local charities. There is a weakness in this approach in that it ignores the rationale behind the refusal of the authorities in England and Wales to assert a similar jurisdiction over organizations external to their own territory: it may in some circumstances be difficult in practice for OSCR and the Scottish civil courts to bring home their directions and orders against a body established outside Scotland, despite its being registered with OSCR, for instance where its officers are all resident outside Scotland. In such a situation, donors and beneficiaries in Scotland may be best in practice to direct any complaints they may have about an external charity to the authorities in the charity’s own jurisdiction of establishment. There is, again, however, some provision for cooperation between OSCR and the other regulators, in particular CCEW, in the fields of information-sharing and enforcement.

The approach of the Northern Ireland system to external charities can be seen as a compromise between the approach in England and Wales and the Scottish approach, and as seeking to offer protection to the interests of both donors and beneficiaries.¹⁶⁸ The approach in England and Wales is followed to the extent that a charity external to Northern Ireland will not be required to register as a charity with the CCNI¹⁶⁹ and will not be subject to the CCNI’s compliance regime, yet will be permitted to call itself a charity both when fundraising and conferring benefit within the jurisdiction, so long as no funds are solicited on its behalf in association with a representation that it is a “registered charity,” in the sense – here – of a charity

¹⁶⁶ *See generally* section 3.2 above.

¹⁶⁷ An external charity which, even though registered with OSCR, claims falsely to be established under the law of Scotland, or managed or controlled in Scotland, is likewise liable to enforcement action.

¹⁶⁸ *See generally* section 4.2 above.

¹⁶⁹ And may not normally register as a charity in Northern Ireland: the position is parallel to that in England and Wales.

registered with the CCNI. There is a criminal sanction against any person soliciting funds in association with a false claim that an organization is a “registered charity” in this sense.

Northern Ireland goes beyond the approach in England and Wales, however, by providing that a charity external to the territory may be obliged to register and to submit to a compliance regime administered by the CCNI, not as a “charity” but as a “section 167 institution,” if it “operates for charitable purposes” within the jurisdiction.¹⁷⁰ If (as it appears to) this latter expression includes fundraising, the effect will be to require an external charity which has purposes that fit the Northern Ireland definition and which is active in pursuit of them in the jurisdiction, by way of fundraising or conferment of benefit or otherwise, to submit to a secondary regime of accountability for its operations in Northern Ireland. The section 167 arrangement amounts, in effect, to an assertion of jurisdiction over external charities active in Northern Ireland parallel to the Scottish one, and there may be similar difficulties of enforcement in practice. There is, however, once more, some provision for cooperation by CCNI with other regulators on information-sharing and enforcement.

Lastly, under arrangements broadly similar to those applicable in Scotland, a charity external to Ireland will be obliged to register with the Irish CRA, and to submit itself to the Irish compliance regime, if it is to represent itself as a “charity” in Ireland – whether when fundraising or conferring benefit or in any other circumstances – unless it falls within the much stricter Irish version of the Scottish section 14 exception by virtue of carrying out no activities whatever in the jurisdiction and occupying no land there.¹⁷¹ In contrast to the position in Scotland, the prohibition against an organization calling itself a charity unless registered or covered by the exception is policed by a criminal sanction rather than civil enforcement,¹⁷² but there is, otherwise, the same assertion of jurisdiction over external charities as in Scotland, with a view, no doubt, to protecting the interests of both donors and beneficiaries. The criminal as opposed to civil law underpinning of the prohibition may to some extent overcome difficulties of enforcement, since any person who makes a misleading representation within the jurisdiction is open to prosecution, not just a charity trustee, but in any event there is also some provision for cooperation by the CRA with other regulators in the fields of information-sharing and enforcement.

This overview alone is perhaps sufficient to show that the treatment of external charities across the four jurisdictions is not the product of a fully coordinated and coherent joint approach by the four sets of legislators. England and Wales has simply persevered with an arrangement dating from a time when the charities regulation system in England and Wales was the only one of its kind in the four jurisdictions. The prohibition against false claims as to charitable status in a fundraising context applies to external charities just as it applies to local organizations which are not registered with the CCEW, and outside the fundraising context the authorities in England and Wales eschew any special charities’ jurisdiction over external charities. Scotland has taken the different line that, in principle, any “charity” active within its borders, whether in a

¹⁷⁰ Charities Act (Northern Ireland) 2008, s. 167(1).

¹⁷¹ *See generally* section 5.2 above.

¹⁷² A person who falsely claims that an external charity, even though it is registered with the CRA, is established under the law of Ireland, or has its seat of management or control in Ireland, is likewise liable to criminal prosecution: 2009 Act, s.46(3).

fundraising context or otherwise, and however well regulated elsewhere, should be subject to the Scottish compliance regime,¹⁷³ and Scotland has been followed in principle by Ireland.

Northern Ireland has backed both horses, following the English approach of outlawing the misleading use in a fundraising context of the term “registered charity” but otherwise allowing external charities to operate as “charities” within the jurisdiction without submitting to its domestic charities regime, yet providing for a secondary compliance regime that may in practice be little less onerous than the principal regime. The net result, it is suggested, has the potential to discourage cross-border activity by external charities, whether by way of fundraising or conferment of benefit, certainly in the three jurisdictions – Scotland, Northern Ireland, and Ireland – that require external charities to submit to a local compliance regime additional to the one in their own jurisdiction.¹⁷⁴

7.4 Implications for external charities and provisional assessment

The implications for external charities can be seen from a snapshot of what the arrangements just summarized are likely to mean for organizations seeking to be active – as external charities – in one or more of the four jurisdictions. The effect will vary according to a charity’s jurisdiction of establishment and the “host” jurisdiction or jurisdictions in which it seeks to be active. To take, first, the obvious case of a large charity established in England and Wales that intends to be active, whether by way of fundraising or conferment of benefit, in each of the four jurisdictions, the implications are as follows.

The charity will be registered with the CCEW as its “home” regulator and subject to the CCEW’s compliance regime;¹⁷⁵ if it is to be active as a “charity” in Scotland, to a significant extent, and with the benefit of a territorial foothold, it must also register with OSCR – if necessary adjusting its governing instrument to enable it to meet the Scottish charity test – and submit itself to the Scottish compliance regime; if it is to operate for charitable purposes in Northern Ireland it will be liable to register and submit itself to regulation as a section 167 institution; and if it is to be active as a “charity” in Ireland it must register with the CRA – again, adjusting its purposes if necessary to ensure that it meets the Irish definition of charity – and submit itself to the Irish compliance regime. In other words, such a charity will be liable to quadruple registration and quadruple regulation. Even if the charity is active in only one of the three jurisdictions other than England and Wales, it will be liable to dual registration and regulation. It is in such circumstances that the differences in detail between the compliance regimes are likely to prove irksome and expensive, when, for instance, a charity finds itself producing different sets of reports and accounts for different regulators.¹⁷⁶

¹⁷³ The policy appears to have originated in the Report of the Scottish Charity Law Review Commission, *CharityScotland* (Edinburgh, Scottish Executive, 2001) (known as the “McFadden Report” after its chair Jean McFadden), paras 3.22-3.28. The report envisaged dual registration as the norm for external charities rather than dual compliance.

¹⁷⁴ There may be some signs of dual compliance operating to discourage medium or small charities established in England and Wales from activity in Scotland in the fact that the vast majority of charities that have dual registration are large or very large charities (by Scottish standards), *See supra* n.78. Charities with less sophisticated administrative capacity may be more daunted by the dual compliance requirements.

¹⁷⁵ Unless it is a charity exempt or excepted from registration.

¹⁷⁶ Even if a charity established in England and Wales were to hive off its Scottish, Northern Irish, and Irish activities to local “subsidiary” charities, that would still amount to multiple registration and regulation overall.

Because of the less demanding approach of England and Wales to external charities, the requirements for a charity established in any one of the other three jurisdictions are slightly less onerous. For instance, a charity established in Scotland which seeks to be active in all four jurisdictions will, of course, be registered with and subject to regulation by OSCR; it will be liable to registration and regulation as a section 167 institution in Northern Ireland and to registration and regulation as a charity in Ireland; but in England and Wales it will be free to operate under the banner of “charity” so long as no funds are solicited on its behalf in association with a claim that it is a charity registered with CCEW. Similarly, a charity established in Northern Ireland seeking to operate as an external “charity” in the other jurisdictions will be fully subject, at home, to its domestic charities system, and as an external charity to the Scottish and Irish charities systems, but in England and Wales its charity trustees and its officers and representatives need do no more than abide by the general fundraising rules, including the rule against misleading use of the term “registered charity.”

To fill out the picture a little further, an organization established outside the four jurisdictions – for instance, a charity established in the United States – that seeks to be active as a “charity” within all three of the United Kingdom’s jurisdictions and in Ireland, will be subject to whatever registration and compliance regime exists in its home jurisdiction, to the full Scottish and Irish charities registration and compliance regimes, and to the section 167 regime in Northern Ireland, but only to the fundraising controls in England and Wales. Notably, therefore, while on the face of it the system in England and Wales offers less protection than the others to the beneficiaries, in particular, of external charities, it has the merit of sparing external charities an additional layer of compliance.

This glance at the implications for external charities of operating across the four neighboring jurisdictions tells immediately, even for organizations originating in one of the four, of duplication, triplication, and even quadrupling of effort. The multiple registration and compliance requirements seem only too likely to act as a disincentive to charities operating across the jurisdictions.¹⁷⁷ If there is to be duplication of compliance effort on the part of the organizations themselves, there is likewise to be duplication of regulatory effort on the part of the authorities. It is certainly too early to assess whether the interests of donors and beneficiaries in any given jurisdiction will in practice be better protected as a result of a charity’s being fully registered and regulated in more than one of the four jurisdictions,¹⁷⁸ but the new arrangements already invite the concern that any improvement in protection will have been bought at too high a price in terms of administrative effort by charities and regulators alike.

It may also be wondered whether sufficient account has been taken by the Scottish, Northern Irish, and Irish legislators, in their assertion of a charities jurisdiction over external charities, of the difficulties of enforcement that have caused the authorities in England and Wales to eschew such a jurisdiction. Even a provisional assessment of the four different approaches to external charities, taken together, suggests that any additional protection required might have been achieved by less heavy-handed means, for instance by harmonizing the efforts of the

¹⁷⁷ As between England and Wales on the one hand and Scotland on the other, the disincentive seems so far to have acted principally against cross-border operation by small to medium sized charities: *see n. 78 supra*.

¹⁷⁸ For example, the Salvation Army is registered in both England and Wales and in Scotland: are its supporters and beneficiaries in Scotland really the more secure for the charity’s being subject to OSCR’s regime as well as the CCEW’s?

regulators within a framework of properly developed mutual recognition arrangements, which would allow for fully reciprocal information exchange and cooperation on inter-jurisdictional enforcement.

8. CONCLUSIONS AND POLICY IMPLICATIONS

This article has sought to analyse the position of an external charity that wishes to fundraise, provide services, or have a presence in a jurisdiction other than the jurisdiction in which it is established. We have focussed on cross-border charities operating in the United Kingdom and Ireland for two reasons: first, the close historical and legal links between the four jurisdictions in this case study provide a rich source of cross-border charity activity for examination; second, the relatively recent introduction of new charity regulation in all four jurisdictions provides a natural starting point from which to conduct our study given the varying degrees of reference to regulation of external charities in each of the respective Charities Acts. Although the article has dealt with cross-border charities as being charities that originate in Scotland, England and Wales, Ireland, or Northern Ireland, an external charity operating in any of these jurisdictions could easily have its place of establishment in another jurisdiction. It follows that the policy implications emerging from the assessment in the foregoing section will be relevant to external charities in the broadest meaning of the term, whether established in another European Member State, the United States, Canada, or Australia, that choose to operate in the UK or Ireland.

As this article has shown, although sharing a similar common law basis, each of the four jurisdictions here has dealt with the issue of external charities independently (or not at all) without reference to the regulatory regimes in the neighboring jurisdictions. The overall outcome of this approach – this article has argued – will be an unnecessary duplication of effort on the parts of both regulators and cross-border charities.

To work effectively, there is a need for each of the regimes to face up to the predominantly unintended consequences of four parallel charity regulatory regimes for cross-border charities. The ideal outcome, to take up one of the suggestions in section 7 above, might be for reciprocal statutory mechanisms allowing for mutual recognition of cross-border charities such that registration in one jurisdiction would be accepted as sufficient in another. Any such system would require charity traceability so that a donor could as easily verify the legitimacy of the external charity as he/she could a domestic charity. The realization of this outcome is dependent upon two factors, the first of which is the existence of general consensus that charities are trustworthy institutions deserving of facilitation as opposed to self-serving organizations the operations of which require heavy policing. The second precondition for a functioning mutual recognition regime is the requirement that each state hold the regulatory standards of its neighbors in esteem. The first factor may be more easily achieved than the second. Given that Scotland, Northern Ireland, and Ireland do not yet have an established track record in charity governance, it may be premature for the latter precondition to be fulfilled to the satisfaction of each individual regulator.

A more modest step towards mutual recognition may therefore lie in the newly established UK and Ireland Charity Regulators Forum, described in section 6 above. The forum has raised the issue of cross-border monitoring of charities at a number of its meetings and to this end established a working group to explore the possibilities of alignment and eventual

passporting of cross-border charities.¹⁷⁹ To date, there has been one meeting of the Cross Border Monitoring subgroup, attended by the three UK regulators, with the general consensus being that the subgroup would be a good vehicle for further discussion about reducing the overarching burden of administration and regulation and developing a common ground approach on issues. It remains to be seen whether this positive start in the dialogue stakes (albeit, unfortunately, without an Irish representative present) can be translated into action on the regulatory front.

In the end, the effective regulation of external charities calls for one primary overseer in the home jurisdiction coupled with a series of linked-up checks and balances in all satellite jurisdictions in which those charities operate. As with all regulatory regimes, proportionality and an ability to see the bigger regulatory picture will be the key to success. Given the range of agents involved, not to mention the fledgling status of some of the regulators, and the subtle shades of difference in the definition of charitable status between the jurisdictions, pragmatism, as much as neighborly goodwill, will be required if cross-border charitable operations are to flourish.

¹⁷⁹ See the minutes of the UK and Ireland Charity Regulators Forum, October 2006 (Belfast) and November 2007 (Belfast).

APPENDIX – CHARITY ACCOUNTING AND REPORTING REQUIREMENTS IN EACH JURISDICTION

As explained in sections 2 to 5 above, all four jurisdictions under consideration have established frameworks for charity registration, accounting, and reporting. The requirement that charities in the UK and Ireland publish financial statements, in most cases accompanied by a trustees' report, and a scrutiny report (audit or independent examination) is central to the regulatory arrangements.

However, each jurisdiction has accepted that very small charities cannot be required to achieve the same levels of financial reporting as the largest, and accordingly has established a series of thresholds, largely based on the gross income of the charity. For example, larger charities are required to have their accounts professionally audited, whilst smaller ones are permitted to have a lesser form of scrutiny – an independent examination – but even so the requirements for appointment of independent examiners, and their reporting duties are laid down in the legislation.¹⁸⁰

The income thresholds at which particular accounting thresholds take effect in each jurisdiction can be summarized as shown in table II. It should be noted that the table indicates the *minimum* requirements, but in each case a charity is free to adopt more rigorous standards of accounting than those necessitated by its income (and in some cases may be required to do so as a condition of its governing document or to satisfy requirements of funders). Also, the table does not take account of additional requirements under company law for charities which are companies, and is based on what would be regarded in each jurisdiction as a “normal charity” – additional requirements may apply to investment fund charities, for example.

As explained in section 1.5, the Irish thresholds are in euro (€) whereas the thresholds for the three UK jurisdictions are in pounds sterling (£). As a result, even when thresholds are numerically similar – such as the audit threshold (£500,000 or €500,000) – Irish charities are actually subject to a lower threshold than those in the UK jurisdictions.

The figures in the table indicate the accounting requirements for charities fully subject to the jurisdiction concerned.¹⁸¹ Where an amount is shown as £0 or €0 it means there is no lower limit – i.e., *all* charities subject to home regulation in the jurisdiction indicated must comply with the requirement shown.

¹⁸⁰ In England and Wales, the duties of independent examiners are determined by reg. 31 of the Charities (Accounts and Reports) Regulations 2008 (SI 2008/629) and by the Directions of the Charity Commission under s.43(7)(b) of the Charities Act 1993 which appear in *Independent Examination of Charity Accounts: Examiner's Guide* (Charity Commission 2008 ref CC32). In Scotland, the duties are stated in reg. 11 of the Charities Accounts (Scotland) Regulations 2006 (SSI 2006/218) (OSCR also produces non-statutory guidance). Power to make regulations for the conduction of independent examination is provided in Northern Ireland (under s. 66 of the 2008 Act) and in Ireland (under s. 51 of the 2009 Act). *See also Morgan supra*, n.1.

¹⁸¹ It follows that no attempt is made to show thresholds applicable to external charities registered under the section 167 regime in Northern Ireland (*see* section 4 above). Moreover, any accounting thresholds under that regime are yet to be established, as they will only be determined by future regulations.

Table II: Income thresholds determining accounting requirements for charities in each jurisdiction¹⁸²

<i>Requirement</i> ¹⁸³	<i>Income threshold:</i> ¹⁸⁴ <i>England & Wales</i> ¹⁸⁵	<i>Income threshold:</i> ¹⁸⁶ <i>Scotland</i> ¹⁸⁶	<i>Income threshold:</i> ¹⁸⁷ <i>Northern Ireland</i> ¹⁸⁷	<i>Income threshold:</i> ¹⁸⁸ <i>Ireland</i> ¹⁸⁸
Must keep proper accounting records	£0	£0	£0	€0
Must publish annual statement of accounts (can be on a receipts and payments basis ¹⁸⁹)	£0	£0	£0	€10,000 ¹⁹⁰
Must register with relevant regulator (local charities in jurisdiction concerned)	£5,000 ¹⁹¹	£0	£0	€0

¹⁸² For England and Wales, and for Scotland, these are actual thresholds as applicable in April 2009 (i.e., for accounting years *ending* on or after 1 April 2009). For Northern Ireland and Ireland, these are the limits which will apply when relevant provisions of the Charities Act (Northern Ireland) 2008 and the Irish Charities Act 2009 are implemented.

¹⁸³ In general the English, Northern Irish, and Irish legislation only triggers a requirement when a threshold is *exceeded* (so, e.g., an English charity with exactly £500,000 income could elect to have an independent examination). However, in Scotland, the requirements are triggered when a threshold is *reached* (so a Scottish charity with exactly £500,000 income would have to have an audit).

¹⁸⁴ These amounts derive from s.3 and ss.41-43 of the Charities Act 1993 (as amended by the Charities Act 2006 and by the Charities Acts 1992 and 1993 (Substitution of Sums) Order 2009 – SI 2009/508). These thresholds now apply to almost all charities regardless of legal form – previously there were a number of different rules for charitable companies (i.e., charities using the legal form of a limited company).

¹⁸⁵ Some of these thresholds took effect only from 1 April 2009 as a result of a review – see *Financial Thresholds in the Charities Acts: Proposals for Change* (London: Office of the Third Sector, Cabinet Office, August 2008). The main effect of the change was (a) to raise the lower threshold at which accounts must be independently examined and at which registered charities must file accounts with the CCEW from £10,000 to £25,000 income, and (b) to raise the threshold at which accruals accounts become compulsory from £100,000 to £250,000 income.

¹⁸⁶ These amounts derive from the Charities Accounts (Scotland) Regulations 2006 (SSI 2006/218) made under s. 44 of the Charities and Trustee Investment (Scotland) Act 2005.

¹⁸⁷ These amounts derive from ss. 63-65 of the Charities Act (Northern Ireland) 2008.

¹⁸⁸ These amounts derive from ss. 47-52 Charities Act, 2009.

¹⁸⁹ In each case the receipts and payments account must be accompanied by a statement of assets and liabilities (or, in Ireland, an income and expenditure accounts plus a statement of assets and liabilities). The receipts and payments basis is not permitted in any of these jurisdictions for charitable companies.

¹⁹⁰ The requirement to publish a statement of accounts does not apply to Irish charitable organizations where the gross income or total expenditure is less than €10,000 (this amount may be increased by regulations up to a figure not exceeding €50,000) – 2009 Act, s. 48(6).

<i>Requirement</i> ¹⁸³	<i>Income threshold:</i> ¹⁸⁴ <i>England & Wales</i> ¹⁸⁵	<i>Income threshold:</i> ¹⁸⁶ <i>Scotland</i> ¹⁸⁶	<i>Income threshold:</i> <i>Northern Ireland</i> ¹⁸⁷	<i>Income threshold:</i> <i>Ireland</i> ¹⁸⁸
Annual report and accounts must be filed with regulator	£25,000	£0	£0	€10,000 ¹⁹²
Accounts must be independently examined (lay examiner permitted)	£25,000	£0	£0	N/A ¹⁹³
Accounts must be prepared on an accruals basis (as opposed to receipts and payments) complying in most respects with the Charities SORP ¹⁹⁴	£250,000	£100,000	£100,000	€100,000
Independent examiner must be professionally qualified	£250,000	£100,000 ¹⁹⁵	£100,000	€10,000 ¹⁹⁶
Full audit required (by a firm of registered auditors). ¹⁹⁷ Accounts must comply fully with Charities SORP ¹⁹⁸	£500,000	£500,000	£500,000	€500,000 ¹⁹⁹

¹⁹¹ As explained in section 2.1 above, a higher limit of £100,000 currently applies to charities which were formerly exempted from registration.

¹⁹² In Ireland, all charities will be required to submit an annual report to the CRA under s. 52(1) of the 2009 Act. Under s. 52(4), the charity's accounts – on whichever basis they are prepared – must be attached to the report, but the exemptions mentioned in n. 190 *supra* will apply. Below this level the charity must therefore file an annual report but is not required to file accounts.

¹⁹³ The Irish legislation uses the term “independent person” rather than “independent examiner,” but in every case, the person must be approved by the CRA (Charities Act 2009, s. 50(3)(a)), which implies a professional qualification requirement.

¹⁹⁴ *Statement of Recommended Practice on Accounting and Reporting by Charities* (Charity Commission, 2005). For charities below the audit threshold, Appendix 5 of the SORP permits some minor simplifications to the framework. In Northern Ireland and in Ireland the regulations are yet to be made, so it is not yet certain whether or not they will refer to the SORP although at least in Northern Ireland this seems likely. As it currently stands, the SORP is a UK accounting standard though under par. 8 it may be applied voluntarily in Ireland. At present, a number of larger charities in both of these jurisdictions apply the SORP, though its use is by no means universal.

¹⁹⁵ In Scotland a professionally qualified independent examiner is required whenever the accounts are on the accruals basis. This necessarily applies to charities of £100,000 income above, but also applies to smaller charities which use the accruals basis either from choice or necessity (e.g., in the case of charitable companies).

¹⁹⁶ Where an Irish charity is not required to produce a statement of accounts (see n. 190) the charity is also exempted from the requirement for audit or independent examination – 2009 Act, s. 50(13).

¹⁹⁷ In England and Wales an audit requirement can also be triggered if the charity has more than £3.26m of assets (even if the income is below £500,000, though only if the income is over £250,000). In Scotland this applies if

As noted in the body of the paper, cross-border charities may well be subject to more than one accounting regime – for example an English charity which is also registered in Scotland must prepare accounts which comply *both* with ss.41-43 of the Charities Act 1993 (as amended) and with s.44 of the Charities and Trustee Investment (Scotland) Act 2005. In practice, because a number of the Scottish thresholds are lower,²⁰⁰ such a charity needs to focus on the Scottish requirements even if the vast majority of its activity is in England. (In theory, the charity could choose to prepare two separate financial statements – one for CCEW and one for OSCR – but since they would both cover the activities of the whole charity there is little point in doing so. However, where one set of accounts is produced to cover both requirements, the report of the auditor or independent examiner has to be carefully worded to satisfy both regimes.²⁰¹)

the charity has at least £2.8m of assets (and at least £100,000 income). No assets threshold applies in Northern Ireland or Ireland.

¹⁹⁸ See n. 194 regarding the status of the SORP in Northern Ireland and Ireland.

¹⁹⁹ This amount is to be set by regulations - €500,000 is the maximum figure permissible.

²⁰⁰ E.g., the starting point at which independent examination becomes compulsory; the level at which accruals accounts become compulsory and the income level at which the independent examiner must be professionally qualified are all significantly higher under the English requirement than under the Scottish rules.

²⁰¹ For further details see *Example 3.1: Examiner's unqualified report for a non-company charity also registered with OSCR* in Charity Commission (2008) *Independent Examination of Charity Accounts: Examiners Guide* (ref CC32).

Article

Think Tanks in Central and Eastern Europe in Urgent Need of a Code of Ethics

Goran Buldioski¹

The think tanks of Central and Eastern Europe, while influencing their governments to improve transparency, legitimacy and integrity, have neglected to develop their own codes of ethics and conduct. Following analysis of existing codes in the nonprofit sector, public service and the profession of policy advisors, this article concludes with a proposal for a code of ethics for think tanks, arguing that the issue must be addressed immediately.

Introduction

Policy making in democratic countries and aspiring democracies should be grounded in evidence-based research. As producers of such research, think tanks and research organizations can have significant influence in shaping policy. The think tanks distributed unevenly throughout Central and Eastern Europe (CEE)² have brought greater scrutiny to the policy-making processes in the region. While they have been instrumental in many reforms and changed how policy is perceived, these organizations have done little to improve their own accountability. A recent report reveals that many large international research organizations engaged in global development³ have poor or nonexistent codes of ethics (Witty 2008), meaning think tanks in CEE are not an exception but part of a broader trend.

The issue of accountability of independent policy research centers⁴ is complex, especially in CEE. Still, because of the urgency of the issue, this article intends not only to open debate but also to push the regions' centers to act. As an initial step in devising a complete accountability process, the article starts with a brief contextual overview of the regions' think tanks, providing a rationale for drafting codes of ethics. This is followed by a short analysis of ethical challenges for individual policy advisers. Assuming that think tanks are more than mere networks of individual policy analysts and advisers, the article juxtaposes the ethical questions for policy advisers with selected overviews of codes of ethics for public servants and self-regulation codes

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² This term refers to the states that acceded to the EU after 2004 along with the countries of the West Balkans, Ukraine, and Moldova. Given the lack of democratic space for participatory policy making in the Russian Federation, Belarus, and the South Caucasus, these countries are not part of this analysis.

³ These organizations are not all think tanks and none are headquartered in the United States, where think tanks are most developed.

⁴ The terms *think tanks* and *independent policy research institutes* will be used interchangeably in this paper, eschewing the more nuanced definitions found in other scholarship (Weaver 1989, Stone and Denham 2004, McGann and Johnson 2005).

for NGOs in the region. The article concludes with a discussion of elements that future codes of ethics for think tanks in the region will have to contain.

1. Think Tanks in CEE – a brief overview

The UNDP defines think tanks as “organizations engaged on a regular basis in research and advocacy on any matter related to public policy. They are the bridge between knowledge and power in modern democracies” (UNDP 2003: 6). The term “think tank” defies exact definition, as the organizations in different parts of the world that appear under the term vary considerably in size, legal form, policy domain, organizational structure, standards of inquiry, and political significance. “The phrase ‘think tank’ has become ubiquitous—overworked and underspecified—in the political lexicon. As think tanks proliferated around the world, traditional definitions have been stretched beyond their original meaning and US-inspired taxonomies have lost their relevance” (Stone 2007: 260).

In CEE, the development of credible policy research and advice has required the resurrection or creation of political debate based on facts and real policy alternatives. As this process has unfolded, the emerging think tank scene has offered much-needed neutrality in a highly partisan political atmosphere. With local demand for evidence-based policy research low, the principal audience for much policy advice has been the myriad international organizations and donors focused on the region. Relying on their support, think tanks in many CEE countries are enjoying significant involvement in the development of public service, democratization, and nation building. Their many successes notwithstanding, however, the market for policy ideas in the entire region remains small and fragmented, making it all the more challenging to battle policy makers’ immaturity and lack of political will (Buldioski 2007). In such a situation, local think tanks must continuously struggle for legitimacy and credibility. Because of this, many exist in hybrid forms combining research and advocacy with capacity-building functions.

2. Why think tanks in CEE need a code of ethics

The issue of ethical principles and codes of conduct for think tanks and policy advisers alike has been discussed in the world’s academic circles for some time. A lack of concerted and practical effort was demonstrated in developed markets for policy ideas already in the early 1980s. Scholars like Amy Douglas lamented that “the only form of ethical analysis routinely used by analysts is utilitarianism in the form of cost-benefit analysis.” While pointing out that many believe “the political process resolves value differences in a democratic society,” she concluded that as a form of ethical thinking this can be limited and even misleading (Douglas 1984).

It is not the aim of this brief article to provide an exhaustive list of reasons that think tanks need a code of ethics, but a few should be noted:

- A code of ethics is a way to develop professionalism in organization and identity, thereby:
 - safeguarding a think tank’s priorities in the face of donors’ goals.
 - showing that the expertise of a local research organization can involve laypeople in the decision-making processes in a meaningful way (Whitty 2008).
 - allowing think tanks to lead by example—respecting the very things they advise governments to respect (transparency, accountability, etc.).

- Many think tanks in CEE are ideologically grounded in liberal democracy and market economics (Pippidi 2003). With such an ideological platform, organizations tend to appear stronger in advocacy⁵ than in fact-based research distorting the image of the sector.
- Think tanks need to distinguish themselves from consulting firms and individual policy experts. While concerned with the narrow classical definition of ethical problems pertaining to conflict of interest or whistle-blowing, think tanks face a much larger spectrum of ethical issues.
- Think tanks do not depend on a single client for their policy advice. Rather, a complex web of international donors, international organizations, and domestic governmental agencies underwrite their research and advocacy. Because this means the principal-agent relation cannot be easily established, accountability lines are blurred.
- A code of ethics should guide an organization's members as they navigate through competing values (Grobman 2007). "Some policy issues are so explicitly moral in nature such as abortion or euthanasia that policy analysis resembles ideological choice rather than problem solving" (Douglas 1984).
- A code is a statement to external stakeholders of the way a think tank "will conduct itself in regard to basic moral principles like honesty and fairness" (Pritchard 1998: 530).

3. Think tanks at the crossroads of ethics

As a second step in this analysis, it is essential to define "ethical values" and take stock of the current trends pertaining to discussions on ethics. Building on the moral philosophy developed by thinkers such as Immanuel Kant and John Stuart Mill, David Schultz defines ethical values as "a broader set of values, norms, and guiding principles that influence the way institutions operate and guide the behavior of individuals who work or operate within them" (Schultz 2004). In a compelling analysis, he makes several important points:

The ethical values that guide the public, private, and nonprofit sectors have traditionally been seen as distinct from one another as well as from the values that guide personal relationships. However, recent trends in the economy and employment are blurring these distinctions.... In a new postmodern world of work, it is marked by a blurring of public and private lives as well as an increasingly fine line separating the three economic sectors. As a result, the ethical rules that apply to different facets of life and work are being challenged, necessitating a rethinking of the moral boundaries and rules governing professional behavior.... As more public/private, public/nonprofit, or private/nonprofit relationships emerge, the lines that used to separate the authority and expectations of each of the three sectors are becoming more difficult to maintain (Schultz 2004: 279, 290, 293).

Table 1 indicates the different notions of ethics emerging in four levels of human social organization:

⁵ This is indeed typical of some very strong centers but they are not representative of the entire sector.

TABLE 1
Ethical Language Across Sectors

<i>Private life</i>	<i>Private sector</i>	<i>Nonprofit sector</i>	<i>Public sector</i>
love/friendship	interest	altruism	duty
trust	contracts	volunteerism	law
family/friends	supply/demand	mission-driven	legitimacy
generous/kind	CEOs	stakeholders	accountability
fathers/mothers	boards of directors	governing boards	citizens/voters
children	shareholders	fiduciary duties	legislatures
temperance	fiduciary duties	fundraising	elected officials
wisdom	thrift		elections
courage	industriousness		democracy
needs/gifts	entrepreneurial		taxation/revenue
	sales/commissions		enhancement/user fees

Source: Schultz (2004: 287).

Given that think tanks operate in the triangle of the public, private, and nonprofit sectors and their research and advice influence many individual lives, a think tank’s code of ethics should consider all four aspects.

4. Codes of ethics for think tanks in CEE – a framework for analysis

What kind of code of ethics would help the region’s think tanks resolve ethical dilemmas? Up to this point, think tanks in CEE have shunned ethical debates almost entirely.⁶ While the discussion here is mainly theoretical, the resolution of this issue has various practical ramifications.

Writing a code of ethics starts with looking at “the perennial debate—what it is about and what it is supposed to achieve” (van Wart 2003). Most of the literature on the subject recognizes three different levels and the code that reflects each of them: a) ideals—codes of ethics; b) norms—codes of conduct; and c) action—codes for rules and regulations⁷. Given its brevity, this article will only provide content analysis and address the structure of the first two levels.

One way to approach this study would be to analyze the codes of ethics in think tanks operating in the United States, where these organizations form a viable industry (Weaver 1989, McGann and Johnson 2005). However, considering that think tanks in CEE lag behind their US peers in development and policy influence, this article takes a different approach. As previously argued, think tanks are positioned between the spheres of NGOs, public service, and individual

⁶ Of the 36 members of the Policy Association for Open Society (PASOS), the biggest umbrella organization in the region (more info at <http://www.pasos.org>), the Center for Social and Economic Research in Poland was the only center with an explicit set of values and an “integrity policy” posted on its web site. None of the 20 grantees of OSI’s Think Tank Fund (which does not participate in PASOS) has a code of ethics (list available at http://www.soros.org/initiatives/thinktank/focus_areas/grantee_folder_initiative_view)

⁷ For a detailed review of such literature see Grobman (2007)

policy advisers. The first two fields have been the subject of regional comparative studies and benefit from the existence of codes of conduct (or “accountability charters,” as some NGOs call them).⁸ While there are no similar regional studies on the ethics of the region’s individual policy advisers, their positions could be easily compared with those of their peers working in other contexts. Comparison of all three, complemented by a list of accountability standards for international research organizations, will lead to enumeration of essential elements of a code of conduct for think tanks in CEE.

4.1 The ethics of policy analysts

Unfortunately, think tanks and individual policy analysts are not working for a philosopher king or queen who evaluates their suggested policy alternatives with the kingdom’s overall welfare in mind. In that ideal situation, a policy advisor would not have to balance analytical integrity, responsibility to the client, and adherence to his or her conception of a good society (Weimer and Vining 2005: 39).

David Weimer presents three extreme positions that individual policy advisers can assume while performing their analysis, that of 1) an objective technician, 2) their client’s advocate, or 3) an advocate of a particular issue. The table below outlines the choices faced by individual policy analysts:

Table 2: Three views on the appropriate role of the policy analyst

	Fundamental Values		
	Analytical Integrity	Responsibility to Clients	Adherence to One’s Conception of Good
Objective technician	Let analysis speak for itself. Primary focus should be on predicting consequences of alternative policies.	Clients are a necessary evil, but their political fortunes should be secondary considerations. Maintain distance from clients; select institutional clients whenever possible.	Relevant values should be identified, but decisions between them should be left to clients. In the long run objective advice promotes a good society.
Client’s Advocate	Analysis rarely produces definitive conclusions. Take advantage of ambiguity to advance client’s positions.	Clients provide analysts with legitimacy. Loyalty should be given in return for access to privileged information and political power.	Select clients with compatible value systems; use long-term relationships to change clients’ conceptions of a good society.
Issue Advocate	Analysts rarely produce definitive conclusions. Emphasize ambiguity and excluded values when analysis does not support advocacy.	Clients provide an opportunity for advocacy. Select them opportunistically; change clients to further personal policy agenda.	Analysis should be used to move toward one’s conception of a good society.

Source: Weimer and Vining (2005: 42)

While each of these extreme roles can be ethically acceptable in specific circumstances, the problem lies in determining how much of each value can be sacrificed when conflicts arise.

⁸ Palidauskaite (2005) provides a comparative analysis of the codes of ethics of 15 CEE countries, while the European Center for Non-Profit Law (Bullain and Marshall 2004) provides an overview of the nonprofit sector.

Some value conflicts, dreadful to analysts, include demands that results be “cooked” or misrepresented. In these situations, Guy Benveniste contends the following:

One step that could reduce the risk of loss of legitimacy for policy experts is to develop a code of ethics; which would include such issues as defining the responsibility of the expert, identifying unacceptable conflicts of interest, determining the expert's obligations regarding secrecy and disclosure, and developing standards for the process of decision-making in emergencies (Benveniste 1984: 561).

He also expects that a code must recognize the possibility of inappropriate pressure on the policy expert. Furthermore, the code should define the expert's obligation in such circumstances and set out the means for disclosing such pressure (Benveniste 1984: 569).

An expert working alone is one thing, but think tanks are more complex, with many analysts gathered together to form an organizational brand. Think tanks acquire social power of their own, distinct from the power of their employers and bigger than its individual analysts. A code of ethics that merely regulates the values and behavior of individual analysts would fail to address the aspect of organizational responsibility.

4.2 Codes of ethics for public service in the transitional democracies of CEE

Forced to redefine their role in society as a whole (Saarnit 2005), public servants in CEE have engaged in broader reforms including introduction of codes of ethics and codes of conduct. The administrations—not cognizant of all problems—started by analyzing the core values of developed democracies. A few of the emerging democracies in CEE adopted a version of the ASPA Code of Ethics (ASPA 2005); others started with the comparative study produced by the OECD (OECD 2000); while EU accession candidates consulted the administrative laws of the European Union. A recent study analyzed the practices of 15 CEE countries. Their codes of ethics were developed and adopted either as primary or secondary legislation during efforts “aiming at professionalization of public service (regulating and controlling the conduct of public servants) and establishing formal accountability to public demands (seeking to apply societal values, constitutional principles, and higher ethical standards in everyday activity)” (Palidaukaite 2005).

While the structures and scope of codes vary depending on their legal status, all new codes emphasized

personal, professional, legal, and public interest values. The newly identified values for public servant professional activity are: legality, serving the public, loyalty to the constitutional government, impartiality, competence, professionalism, honesty, integrity, disinterestedness, political neutrality, transparency, and openness (Palidaukaite 2005: 46).

The table below provides a comparative overview of the most frequent core public service values underlying the respective code of ethics.

Table 3: Comparison of Codes of Ethics between CEE Countries, the US and OECD members

Core Public Service Values	Code of Ethics		
	CEE countries (summary)	American Society for Public Administration	Ethics Measures in OECD countries
	legality serving the public loyalty to constitutional government impartiality competence professionalism honesty integrity disinterestedness political neutrality transparency openness	Serve the public interest. Respect the Constitution and the law. Demonstrate personal integrity. Promote ethical organization. Strive for professional excellence.	impartiality legality integrity transparency efficiency equality responsibility justice

While many policy centers have been researching and advising on administrative reforms, they have not been keen to develop their own codes of ethics and conduct. Defenders of think tanks might highlight the distinction in levels of accountability between these nongovernmental organizations and elected or appointed government officials. While it is clear that the latter should be the subject of greater scrutiny, think tanks should not take their own ethical reputations for granted. Most of the values listed above are similar to those underlying ethical research and advocacy. Moreover, think tanks have been largely supported by international donors and organizations. Given the specificity of their position, there is a greater need for a clearly communicated set of values towards the government and the citizenry (the ultimate beneficiary of any policy change). As will become apparent in the next section, think tank standards in this area also lag behind the rest of the nongovernmental sector in the entire region.

4.3 NGO codes of ethics in CEE

In stark contrast to the public or private sectors, which intend to serve the public good or maximize profit, nonprofit entities are driven by a specific mission. “The nature of the nonprofit sector, which is neither based on market principles nor constrained by constitutional principles, makes it a unique economic sector” (Schultz 2004). By the end of the last decade, the region’s nongovernmental organizations were on the vanguard of developing a range of joint codes of ethics, conduct and accountability in Europe. (Bullain and Marshall 2004).

In effort to consolidate hard-won gains, a number of umbrella groups and national networks resorted to drafting statements on ethical practices. Ranging from simple lists of “oughts” to detailed prescriptions for conduct, governance structures and fund-raising, most of these codes were a mixed bag of ethical values, codes of conduct and accountability standards encompassing their members, donors, and target groups. These codes were mostly voluntary—few included criteria for compliance. What criteria there were, although nominally required for membership in some networks, were almost never enforced (EU and ECNL, forthcoming).

Estonian, Slovak, and Hungarian NGOs advanced the furthest in these developments. The areas they emphasized are presented in the table below:

Table 4: Comparison of Slovak, Hungarian and Romanian NGO Codes.

	NGO Codes		
	Slovakia (Donor's forum)	Hungary	Estonia
Key Areas	governance communication/disclosure finance administration personnel public policy mission strategy evaluation (three levels of compliance: - legal compliance - good practices for accountability - practices of excellence for accountability)	governance conflict of interest planning and evaluation finances fundraising transparency	governance civic courage and care for social justice sustainability and prudence in using funds and resources responsibility and accountability openness and transparency independence and avoiding conflicts of interest honouring commitments and recognition of authorship of ideas tolerance

Source: European Commission (2009)

Following the regional trend, NGOs in other CEE countries have developed their own common codes over the past several years. The European Center for Not-for-Profit Law produced a manual to assist them specifically in the area of governance (Wyatt 2002). The insightful and useful manual emphasized the practical and formal aspects of accountability. It standardized a model that included the NGO's mission, accountability, transparency, use of resources, board leadership, management practices, and avoidance of conflicts of interest. As such, the manual is of great use of think tanks when setting their governance structure as NGOs. On the other hand, the manual fails to pay due attention to the ethical responsibility of policy research and its impact on the various stakeholders, aspects that carry particular weight in the work of think tanks.

4.4 Accountability principles for research organizations

In 2008, the One World Trust, an independent think tank monitoring accountability at the global level, released an unprecedented report looking at the accountability standards of international research organizations engaged in global development (Whitty 2008). Though not directly pertaining to the CEE region and emphasizing an umbrella concept of accountability,⁹ this report puts forward a novel concept worth considering. It stipulates three normative reasons for accountability: formal accountability, accountability on claims made, and accountability for the impact. While formal accountability is a classic concept usually embedded in contracts with donors or clients, the other two build on more recent discussions relating to organizations involved in research and international development. By calling for accountability both on claims made on behalf of a particular group and on results of policy changes that an organization pushes for, the report makes a strong case that “a research organization should be accountable to more than simply those with whom it has a formal relationship” (Whitty 2008: 20).

⁹ “Accountability is the processes through which an organization makes a commitment to respond to and balance the needs of stakeholders in its decision-making processes and activities, and delivers against this commitment” (Whitty 2008: 8).

The report describes four principles of accountability: participation, transparency, evaluation, and feedback mechanisms. Regrettably, this valuable model is limited to analysis of policy processes, their improvement, and stakeholder analysis. Little or no attention is given to other core ethical aspects such as the political neutrality and technological integrity of the research organization.

5. A code of ethics for CEE think tanks

Montgomery van Wart (2003) outlines the main substantive challenges in constructing a code of ethics: a) the blurring of the system of ideals, norms, and actions is inevitable; b) stating a principle is not the same as its enforcement; and c) multiple abstract principles may apply to a single case. Looking at the diverse models presented in this article, it is obvious that there is no panacea for code of ethics applicable to all region's think tanks. All of the previous models take into consideration contextual or organizational specificities. Each think tank should consider its specific policy environment and define its own priorities. However, the present analysis helps us to identify some core ethical values that should be linked to the essential elements of all codes of ethics and conduct for think tanks.

Table 5: Elements of codes of ethics and conduct for think tanks in CEE

Ethical value	Element in the code of ethics
independence	grounds for independence: political, financial, expertise
legitimacy	link to expertise or to a particular target group
integrity, political bias or neutrality	declared ideology, links to interest groups or advocacy coalitions
impartiality, fair use of research methods, competence	Definition of research methodology
transparency, competence	definition of public policy process, specialization if applicable
honesty, accountability (to multiple stakeholders)	standards of accountability to clients, donors, government, and population
serving the public	definition of policy products as public goods
Code of conduct	Element in the code of conduct
professionalism and mission	professionalism and dedication to the mission of the think tank
disinterestedness	policy on conflict of interest
transparency, disclosure of information	procedure on disclosure of information within the organization and to the public

Conclusion: CEE think tanks have no time to spare

Home to admirable policy analysts, think tanks in CEE have excelled in many research areas and assisted the transition processes and reforms in their countries. This article argues that they have unjustifiably neglected the development of their own codes of ethics and conduct. Straddling the line between the public, nonprofit, and private sector, these centers could choose from the abundant models that other sectors have already developed. Using existing platforms for NGOs in their countries might be a logical step in adopting a code of ethics from within the nonprofit sector. Alternatively, think tanks could dedicate themselves to ethical values defined

by their public administration or governmental sectors. Whatever its source, the list of ethical values should include integrity, legitimacy, commitment to impartiality and competence, accountability to all affected stakeholders of their research and advocacy.

Think tanks do not act alone in the policy environment. Neither are they obliged to be neutral or free of ideology. Many in the region are staunch advocates of certain doctrines and concepts about the development of their own societies. The only position a think tank should avoid is becoming the advocate of a certain client, because that loss of independence undermines the impact of a think tank's research. It is essential for think tanks to be explicit and transparent about the ethical values underlying their research work and advocacy. At present, think tanks enjoy a reputation as neutral transmitters of scientific ideas and policy analysis. This independence is their key feature well positioning think tanks to promote good communication between state and society. Likewise, the media is also keen on using think tank experts who they expect are serving the public interest.

The lack of a "framework of values" and rules for conduct for think tanks—among the most resolute proponents of government transparency and accountability in CEE—could soon have negative consequences. In spheres of policy where governments are hostile to such organizations, think tanks have to guard against attacks on independent policy research. Defining a proper code of ethics and code of conduct is a way to do that. Think tanks in CEE can only benefit from proposals in this article by being resolute in formulating these essential and overdue codes.

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Europe

Trading—A Survivor’s Guide: Guidance Notes on Charity Trading in the UK

Pesh Framjee¹

1. THE DREADED TRADING

An increasing number of charities are faced the need to finance their work from earned income and as expenditure outpaces income there is a constant need to look for innovative means of income generation. On the voluntary fundraising side charities are trying to increase their slice of the fundraising cake as well as increase the size of the cake itself. However, many charities have also recognized that in addition to tapping the altruistic side of society there is potentially a large source of income that can be motivated through a mix of altruism and some personal advantage. Hence charity shops, commercial sponsorship, affinity card schemes and other sources of charity income generation that arise from earning income.

Contrary to popular misconception, many charities do have earned income streams arising from fees and sales of products and services. Indeed, earned income is a significant proportion of the income of the UK charity sector. Charities are providing products and services for a fee on a regular basis and these arrangements often leads to the dreaded “trading” with its consequent charity law and tax implications. As charities widen the range of their income generation efforts, the incidence of trading increases and income generation activities come under close scrutiny to establish what is behind the transaction.

Surprisingly, a number of charities continue be unaware of the ramifications. In the extreme, trading activities can threaten the charitable status of a charity since the generation of income per se, albeit for charitable purposes, is in itself not a charitable objective. Apart from the threat of endangering the charitable status there are also the taxation and practical “business” issues to consider.

The aim of charity trading is usually to generate income and profit and it is important to avoid having to pay tax on that profit. Charities are not automatically exempt from tax. The trading exemptions are restrictive and often difficult to fall within. What is trading?

What is trading?

What then is trading? My dictionary refers to “the practice of some occupation, business, or profession habitually carried on especially when practiced as a means to a livelihood e.g. shop keeping, commerce, buying and selling.” However our everyday understanding is considerably widened by Section 832 of the Taxes Act 1988 which states that a trade includes “every trade, manufacture, adventure or concern in the nature of trade.” It does not cease to amaze me how unhelpful this circular definition which originates almost 200 years ago is. Consequently, the

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courts have on several occasions had to scrutinize activities to decide whether they fall within the definition of trade.

A Royal Commission reported in 1955 and identified six main badges of trade:

- (i) the subject matter;
- (ii) period of ownership;
- (iii) frequency of transactions;
- (iv) supplementary work;
- (v) cause of sale; and
- (vi) motive.

Some of the income generation activities of charities are easily recognizable as traditional charity trading - the purchase and sale of goods, Christmas cards and such. In addition, more and more charities are being enmeshed in the trading net for activities that they had thought were part of their normal fundraising effort. For example, commercial sponsorships, affinity card schemes, lotteries, conference income, etc.

What is allowed—Statutory Exemptions

Section 505 of the Income and Corporation Taxes Act 1988 (ICTA 88) gives exemption for trading profits which are used solely for charitable purposes providing:

- the trade is exercised in the course of the actual carrying out of a primary purpose of the charity;
- or the work in connection with the trade is mainly carried out by the beneficiaries of the charity.

The Charity Commissioners' guidelines also recognize these categories of trading as acceptable and a charity in so doing will not normally endanger its charitable status. Nevertheless, it must be appreciated that when considering primary purpose trading a distinction must be made between activities which are directed to the achievement of the objectives and activities, which although they help the charity, cannot be described as carrying out or carrying out part of its charitable purposes.

For example, a church that may have charitable status with the objective of advancing religion would find that the sale of religious books qualifies as part of its primary purpose although the sale of other books would not. This is despite the fact that the profits from both types of sales are used exclusively for its charitable objects.

The sale by a charity for the handicapped of goods produced in a workshop staffed by the beneficiaries would qualify under the second alternative. As could the sale by an international aid charity of goods produced by its beneficiaries in developing countries.

Of course a prerequisite for a charity when it is considering trading is that it should have the constitutional powers to do so. Having such a power, even when it refers to non primary purpose trading, should not in itself preclude an organization from having charitable status. However, most modern governing instruments make reference to trades that are within the tax exemptions.

The question to be asked is whether the trading is on such a scale that it might dominate the organization's original charitable purpose. If the organization's powers allowed trading to such an extent, it would be questionable whether the organization could be said to be established for exclusively charitable purposes.

On the other hand incidental and insignificant trading is usually permissible by law and although any profits that do not fall within the statutory tax exemptions would be taxable there are further avenues open to the trustees. Strictly, if a charity carried out non-exempt trading activities at the same time, they could lose the exemption altogether. Within limits, HMRC used to treat the primary-purpose activity as a separate, exempt trade, but case law has said that both activities have to be treated as a single trade.

The 2006 Finance Act now specifically requires the trade to be split into two, with the primary-purpose one exempt and the non primary purpose trade being taxable. The same applies to the parallel exemption where the trade is mainly carried on by beneficiaries of the charity. Following changes to the trading exemptions found in Section 505 ICTA '88 HMRC have published new guidance. This explains that trading receipts should be allocated between trades that are taxable and non taxable on a reasonable basis. In their guidance HMRC have explained that it is necessary to divide the charity's trade into a number of different statutory forms, which, for chargeable periods beginning on or after 22 March 2006, include "deemed trades." They explain the position as follows:

All trading exercised in the course of carrying out a primary purpose of the charity (e.g. a theatre charity selling programs, a charitable school charging pupils, or a residential care charity charging residents) is referred to as "primary purpose trading." S505 (1)(e)(i) ICTA 1988. The profits of such trades are not taxable if they are applied for charitable purposes.

Where a charity's trade is carried out partly in the course of carrying out a primary purpose of the charity, and partly for non-primary purposes, Section 505 (1B) ICTA 1988 deems each part as a separate trade for tax purposes. The primary purpose deemed trade is not taxable. S505 (1B)(a) ICTA 1988 but the non primary purpose trade is taxable. This is discussed in more detail below.

The exemption from tax can also extend to other trading, which is not overtly primary purpose in nature but which is ancillary to the carrying out of a primary purpose. This trading can still be said to be exercised in the course of the carrying out of a primary purpose. It is therefore part of the primary purpose trade. This is discussed in greater detail below.

Beneficiary Trading encompasses trades which are non primary purpose but carried out mainly by beneficiaries (e.g. the manufacture and sale of items by residents). Where the work in connection with a charity's trade is carried out partly by beneficiaries, the part not carried out by beneficiaries is deemed to be a separate trade, which, assuming it is non-primary purpose, will be taxable unless the small trading exemption applies

Small trades (Section 46 FA 2000)

Since April 2000 there is also a relief for small trades. The relief is from tax on profits where there is a reasonable expectation that turnover is either below:

- £5,000, or the lower of
 - £50,000, and

- 25% of the charity's total incoming resources

If a charity inadvertently breaches the thresholds it will have to establish that the trading turnover and/or total incoming resources were different to its “reasonable expectation.” HMRC have explained that they will consider the circumstances to establish whether the charity had reasonable grounds to consider that it would not fall outside the exemptions. For example, this could be established by budgets and forecasts or past trends.

Extra statutory concession for fundraising events (ESC C4)

Also see separate guidance note on Fundraising events

In recognition of the fact that ICTA 88 Section 832’s unsatisfactory definition of trading would catch a number of activities that have traditionally been associated with charity fundraising, (bazaars, jumble sales, etc) HMRC published an Extra Statutory Concession, (ESC C4) This concession was similar yet different to the VAT exemption for fundraising events and therefore caused unnecessary complications and as a result of the Charity Tax Review the two have been harmonized and ESC C4 now states:

Certain events arranged by voluntary organisations or charities for the purpose of raising funds for charity may fall within the definition of “trade” in Section 832 ICTA 1988, with the result that any profits will be liable to income tax or corporation tax. Tax will not be charged on such profits provided: a. the event is of a kind which falls within the exemption from VAT under Group 12 of Schedule 9 to the VAT Act 1994 and b. the profits are transferred to charities or otherwise applied for charitable purposes.

There are however certain caveats. All the conditions of the concession must be met. This area is complicated.

Note that for trusts this has now been enshrined in law – Section 529 of the Income Taxes Act 2007 states:

Exemption for profits from fund-raising events

(1) The profits of a trade carried on by a charitable trust are not taken into account in calculating total income so far as they arise from a VAT-exempt event.

(2) Subsection (1) applies so far as the profits are applied to the purposes of the charitable trust only.

(3) An event is a VAT-exempt event if the supply of goods and services by the charitable trust in connection with the event would be exempt from value added tax under Group 12 of Schedule 9 to the Value Added Tax Act 1994 (c. 23) (fund-raising events by charities and other qualifying bodies).

Trades that are partly primary purpose

Charities also carry out trading which is not part of the primary purpose of the charity but which is typically undertaken to raise funds to be applied for charitable purposes (e.g. sales of promotional items or commercial sponsorships). Where a charity's trade is carried out partly in the course of carrying out a primary purpose of the charity, and partly for non-primary purposes, Section 505 (1B) ICTA 1988 deems each part as a separate trade for tax purposes. The charity’s non-primary purpose deemed trade is not exempt from tax, unless the work is carried out mainly or partly by beneficiaries - or the small trading exemption applies (see above).

HMRC has explained that this would apply in cases where the trade might deal in a range of goods or services only some of which are within, or ancillary to, a primary purpose. Or the trade might deal with some customers who cannot properly be regarded as beneficiaries of the charity. Examples of such trading cited in the HMRC guidance include:

- a shop in an art gallery or museum which sells a range of goods, some of which are related to a primary purpose of the charity (i.e. education and the preservation of property for the public benefit e.g. direct reproductions of exhibits and catalogues), and some of which are not (e.g. promotional pens, mugs, tea towels, stamps, etc.)
- the letting of serviced accommodation for students in term-time (primary purpose), and for tourists out of term (non primary purpose), by a school or college
- the sale of food and drink in a theatre restaurant or bar both to members of the audience (beneficiaries of the charity) and the general public (non-beneficiaries).

Ancillary Income and Part Exempt Trades

As highlighted above HMRC have also extended the exemption from tax to other trades, which in themselves are not primary purpose but which are ancillary to the carrying out of a primary purpose. They have cited the example of “the sale of food and drink in a cafeteria to visitors to exhibits by an art Trust or museum.” Such trades will qualify as primary purpose trades.

HMRC have also recognized that in some cases a primary purpose trading activity may include an element of some non-exempt trading.

HMRC will establish whether the non-exempt activity can be assessed as a separate trade. In the example of the shop, if there was a separate shop selling the souvenirs it would probably be assessed as a separate trade.

In the past HMRC adopted a rule of thumb and if the trade was seen to be part of a single trade and the turnover of the non-exempt part amounts to less than ten per cent of the total trade the Revenue will usually permit it to be disregarded as *de minimis* so long as it is not large (defined as £50,000). If it is not treated as *de minimis* HMRC explained that they may seek to tax the whole trade. This guidance has now been superseded and HMRC explains:

The exemption from tax can also extend to other trading, which is not overtly primary purpose in nature but which is ancillary to the carrying out of a primary purpose. This trading can still be said to be exercised in the course of the carrying out of a primary purpose. It is therefore part of the primary purpose trade. Any impression that it is a separate category is incorrect.

Examples of trading which qualifies as primary purpose because it is ancillary to the carrying out of a primary purpose are:

- the sale of relevant goods or provision of services, for the benefit of students by a school or college (text books, for example)
- the provision of a crèche for the children of students by a school or college in return for payment

- the sale of food and drink in a cafeteria to visitors to exhibits by an art gallery or museum
- the sale of food and drink in a restaurant or bar to members of the audience by a theatre
- the sale of confectionery, toiletries and flowers to patients and their visitors by a hospital.

Public benefit

When considering the issue of what trading is allowable there is need to consider the issue of the public benefit test as enshrined in the Charities Act 2006. The Act has for the first time set out in legislation charitable objectives and established the over arching requirement to demonstrate that the activities provide public benefit.

For the first time the law requires charities which advance education, religion or relieve poverty to demonstrate explicitly they deliver public benefit.

The Charity Commission has emphasized that there is a particular focus on fee charging and this is of relevance when considering the issue of trading. The Charity Commission has stated that charities which charge relatively high fees must demonstrate accessibility to those facilities or services.

It will not normally be possible to demonstrate public benefit through indirect benefits alone, such as savings in public expenditure through the provision of a service like education or health. They have explained that they think that all charities should give an account each year of the public benefit they provide.

For fee-charging charities where public benefit is not immediately obvious given the high level of fees charged, one suggestion we will explore is to expect those charities also to assess and report the value of the tangible benefits they bring, alongside the value of the tax breaks they receive.

The Charity Commission has explained that “there are two essential elements of the public benefit requirement: 1. Benefit – to be charitable the pursuit of an organization’s purposes must be capable of producing a benefit which can be demonstrated and which is recognized by law as beneficial; and 2. Public – that benefit is provided for or available to the public or a sufficient section of the public.”

They go on to explain that this can be broken down further into four principles which show whether an organization provides benefit to the public.

1. There must be an identifiable benefit.
2. Benefit must be to the public, or a section of the public.
3. People on low incomes must be able to benefit.
4. Any private benefit must be incidental.

Other useful guidance

The Charity Commission has published guidance which is available from the publications section on its website – See CC35.

HMRC's detailed guidance for charities can be found on the charities section of the HMRC web site. In addition, in June 2007 HMRC published detailed guidance on trading for Higher Education Institutions.

This guidance was prepared for the British Universities Finance Directors' Group (BUFDG) and focuses on universities but the principles would apply to all charities. This guidance includes a flow chart for considering a university's trading activities. This has been reproduced at Appendix 1 with HMRC permission.

2. SPECIFIC ACTIVITIES

In this section I have attempted to briefly look at the more common trading activities carried out by charities

Sale of donated goods

When one thinks of charity trading it is the traditional charity shop selling donated goods that come to mind. Neither the Charity Commissioners nor HMRC treat the sale of donated goods as trading. The sale of donated goods is treated by them as the mere conversion of donated gifts into cash. As a result donated goods can be sold by a charity without fear of endangering charitable or tax status.

HMRC has explained that this applies even if the donated items are sorted, cleaned and given minor repairs. However, they have warned that if the goods are significantly altered or processed so that they are sold in a different state from that in which they were donated, the sale proceeds may be regarded as trading income. For example, if a charity makes donated fabric into clothes for sale, this will amount to a trade.

The VAT rules take an even more favorable view and offer the best possible VAT situation. The sale of donated goods is zero rated. This applies to charities as well as any "taxable person" who has covenanted by deed to give all the profits of the supply of donated goods to a charity. Consequently, it is possible to reclaim all the input VAT associated with the supply without having to charge any output VAT.

There are schemes gaining popularity whereby the charity sells goods on behalf of the donor who then Gift Aids the proceeds to the charity. HMRC has agreed to specific rules that need to be followed but it is relevant to note that this is not the sale of donated goods and any commission paid by the owner for the goods will be trading income. In addition, since the amount of zero rated sales will inevitably decrease there may be an impact on VAT recovery and a possible impact on rates (See Section 7).

Corporate sponsorship

Also see separate guidance note on corporate partnerships and donations

Many charities are now targeting the marketing budget of corporate donors, instead of seeking pure charitable donations. What starts as a means of profitable fundraising can have fairly disastrous tax implications if the arrangements are not properly structured and planned.

Typical examples are commercial sponsorship and joint ventures. In these cases it is important to see whether the charity, in return for the sponsorship, is offering free publicity. There is no problem with the mere acknowledgement of a donation. On the other hand if the "gratitude" offers free publicity for the corporate organization (e.g., by prominent use of their

logo or strap line) then it is quite likely that it will be construed that the charity is supplying an advertising service. This is within the realms of the dreaded “trading” and the making of “taxable supplies,” with implications both in terms of corporation tax and VAT.

It is vital when looking a transaction of this sort to establish the exact substance of the transaction and see whether it is a true donation or commercial transaction, with the charity supplying advertising and publicity services. In essence, if the payments are made in exchange for something, such as advertising of the sponsor, the payment is often no longer treated as a pure donation. For example, a charity may publicize and acknowledge the sponsor in publications, posters, etc. In such cases if this is simply a mere acknowledgement then the payment can be treated as a donation.

The key element is that the charity must remain passive – if the sponsor publicizes the fact that they have made a generous donation and derives benefit from that the donation will still be treated as a donation. When looking at a transaction of this sort HMRC will examine the substance of the transaction and may conclude that the charity may be selling advertising services. HMRC looks carefully at this and have stated that, references to a sponsor which amount to advertisements will cause the payments to be treated as trading income. HMRC will regard a reference to a sponsor as an advertisement if it incorporates any of the following:

- large and prominent displays of the sponsor's logo,
- large and prominent displays of the sponsor's corporate colors,
- or a description of the sponsor's products or services.

Similarly, if a charity provides the sponsor with goods or services in exchange for the payment it may be deemed to be trading with attendant tax consequences. Some of the examples provided by HMRC may seem to be fairly innocuous they include the use of the charity’s mailing lists, logo, exclusive right to sell goods and services on a charity’s premises etc.

This may not be altogether simple and clear. A corporate sponsor might make a very large payment and indeed receive some form of advertising benefit. Even though it may be argued that the benefit is not commensurate with the payment made, case law now provides that it is not possible to apportion the payment between the elements relating to the advertising service provided and a pure donation for VAT purposes. Unless there is a specific price for the benefit (which will bear VAT) and the balance of the payment being totally discretionary (a gift, which will not bear VAT), VAT could be due on the whole payment.

Allowing use of the Charity’s logo

Payments for the use of the charity’s logo can lead to the taxation of intellectual property. The marketing by charities of their name and logo to commercial organization who then use these to endorse the commercial organizations own products is likely to constitute a trading activity leading to taxable income.

It could also be interpreted as a supply of a trademark or sale of copyright. It is unlikely that a provision of a name or logo for a single fundraising event would give rise to tax liability. On the other hand if there is a form of contract governing the use of the charity’s name and its provision of promotional services to commercial organization, then the income may be assessable as trading income and would not be exempt.

The rules are not altogether straightforward and HMRC has explained that where the logo came into existence prior to 1 April 2002 a one off payment (received without any deduction of tax) is charged to tax as miscellaneous income and no exemption is available apart from the small trading exemption.

There is also tax exemptions for income which meet the criteria of an “annual payment” and this could apply where a commercial organization make annual payments solely for the use of a charity's logo. Such arrangements need to be structured carefully to ensure they meet the definition of an annual payment.

Where the payer is a UK company, payment can be made without the deduction of income tax. However in certain other circumstances the organization making the annual payment may have to deduct tax at the basic rate from the payment and the charity can reclaim the tax. The payment must be:

- applied solely for charitable purposes
- made under a legal obligation
- recurring (the payments must be capable of recurring each year but the obligation may be contingent)
- treated as pure income profit in the hands of the charity (a sum is “pure income profit” if it comes to the charity without the charity having to do anything in return)

For charitable companies, where the logo came into existence on 1 April 2002 or later, a logo is treated as an “intangible fixed asset.” Non-trading gains on intangible fixed assets received by charitable companies are exempted from tax under as long as the gains are applied charitably.

The VAT position is somewhat different and the grant of a right to a business sponsor to use the charity's logo is treated as a supply of taxable services for VAT purposes. HMRC have clarified that the granting of the right for a sponsor's logo or name to appear in a charity's publication or on their website is a supply of services for VAT purposes. The same principles apply when a charity grants the right to a business sponsor to use the charity's logo.

This may seem at odds with the concept discussed earlier that where the charity remains passive and does not provide goods and services in exchange for a payment the payment will usually be treated as a donation. HMRC point out that it is the granting of the right to use the logo that triggers the taxable event for VAT purposes rather than any activity (or lack of it) undertaken by the charity or the size and/or prominence of the logo.

Research Income

Some charities often carry out research on a paid basis. If the payment is in the nature of a grant which merely requires the research to be completed, and if the carrying out of research is part of their charitable objective, there should be no problem. However, if the person paying for the research acquires rights to the results it could be construed that the research is not for the benefit of the public and thus not for charitable purposes and the charity could be deemed to be trading. This is not likely to be the case where the funding organization is itself a charity or a

government body but could apply say with a pharmaceutical company funding medical research through a charity.

When considering this aspect HMRC and the Charity Commission will review whether the research is made available in the public domain and whether it is impartial and does not simply advance the views of the sponsoring organization.

HMRC's published guidance for Higher Education Institutions incorporates guidance from the Charity Commission on research and within that guidance they have explained that to be charitable, research carried out or funded by a charity must both fall within its objects and powers and be carried out for the public benefit. They explained that to do this the research must fulfil each of the criteria set out below:

- "Research must be in a subject, or be directed towards establishing an outcome, which is of value and calculated to advance or enhance knowledge and understanding. Research into a subject may be of public benefit whether or not it is directed at testing any particular hypothesis; and if it is so directed, whether the hypothesis which the research sets out to test is proved valid or invalid. In each case knowledge and understanding should be advanced or enhanced.
- Research must be undertaken with the intention that the useful knowledge acquired from the research will be disseminated to the public and others able to utilize or benefit from it and so advance charitable purposes.
- Any research which results in useful knowledge should be disseminated. It includes making the knowledge available or otherwise accessible. This applies equally to research which will use its results whose value is immediately apparent and may be of practical application, and to research the results of which simply add to the store of useful knowledge and which may be developed further by research in further generations. Dissemination may take the form of practical application of the research outcome.
- Research must be justified and undertaken for the benefit of the public and not solely for self-interest or for private or commercial consumption. Public benefit may arise from research in a variety of ways. In many cases, the dissemination of the useful knowledge gained will constitute adequate public benefit. In other cases, particularly, but not exclusively, where the charity's objects are directed towards the provision of charitable relief for beneficiaries, public benefit may arise from the practical development and application of a research outcome. This might be achieved with or without collaboration with a commercial partner. Research undertaken not as charitable activity may still, nonetheless, be undertaken by a charity."

Closed Courses

HMRC has also emphasized that closed courses will not be seen as a charitable activity for public benefit. They have explained that a closed course is broadly one where:

- The attendees are drawn from a narrow range of the public, or
- The criteria for selection for the course exclude the wider general public, or

- The benefit is not to a sufficiently wide sector of the public

A typical example would be where a University provides a course or training specifically for a single business. HMRC considers that courses which are “closed” typically have a different purpose to a university’s main educational activities. In determining the tax treatment of a closed course, as with research activities, the main point to consider is whether the activity passes the charitable purpose requirement. Closed courses are clearly within the charitable purpose heading of the advancement of education, but the question is whether they also provide a private benefit.

Notwithstanding the above there are clearly cases where a charity may make courses generally available but also run some courses which are focused on a narrower sector (e.g., a particular industry) and that in itself should not mean that the activity is taxable.

Non-student lettings and use of the other facilities

HMRC have reemphasized that the use of student residential accommodation and other university and school owned premises by non-students and associated income generation activities such as the provision of bars, external catering, and conferences, may be non-primary purpose trading activity. Providing accommodation, catering, and other facilities to conferences run by the university where the focus is on education and research topics and the sharing of knowledge or best practice in teaching or research, should be accepted as being part of a primary purpose trade.

However, the provision of accommodation and similar services to third parties for the purpose of generating income by utilization of surplus capacity would normally be non-primary purpose trading activities and subject to tax. (but there are some exemptions—see section below on property letting) HMRC has provided detailed guidance on the cost allocation principles.

Consultancy

With regard to consultancy income the same principles apply. HMRC have explained that consultancy services are usually carried out with a profit motive and will often not meet the primary purpose criteria. However, in many cases the consultancy services may be clearly furthering the charity’s objectives and simply because they also make a profit does not mean that the income is taxable as the primary purpose trading exemption should apply.

In the case of Universities HMRC has explained that where typically it can be demonstrated that the main purpose of the charity in carrying out the consultancy is to obtain access to results for academic research or teaching purposes it may be possible to treat it as a primary purpose trade. Similarly, if consultancy is carried out by the students it may meet the “beneficiary trading” rules. As with all non primary purpose trading proper cost allocation is needed.

Contracting

Many aspects of charity funding are moving from grants to contracts. The contract culture with its concept of an exchange transaction and service level agreements could lead to the charity being seen to carry out a trade. For example, a charity providing housing is in fact trading. The absence of a profit motive is not conclusive to establish that it is not trading. In most cases it is more than likely that charities which contract out their services will be fulfilling their primary purpose. In the example cited above if the charitable objective was to provide housing then it would be within the realms of primary purpose trading.

Similarly, charities are engaging more in public service provision and contracting with Local Authorities and government departments to provide services for a fee. In most cases the provision of such services is within the charitable remit of the organization and the activity should qualify as a primary purpose trade. On the other hand universities and schools whose primary purpose is education are seen to be trading if they hire residential facilities to tourists in the holidays, because holiday lets are unrelated to the provision of education. There are also of course VAT considerations. There are exemptions for welfare services carried out on a not for profit basis and charities should ensure that they are aware of the rules.

Property letting

For income or corporation tax purposes, income derived from property is taxable under Schedule A and/or Schedule D. Schedule A includes rental income, ground rents, amounts received as payments for right of access, etc.: (see ICTA 1988, s15(1)).

Many charities provide space that is used by third parties to run conferences and other events. Where all that is being provided is room hire, albeit furnished, and the only services being provided are those that a landlord would normally provide (cleaning, security, power supply etc) then the income received should be income from property taxable under Schedule A. However, if additional services are provided such as catering, hire of equipment, supply of materials then the whole of the income is likely to be treated as trading income. If the conferences are of a nature that promote the charities objectives then this income could be seen to be primary purpose trading.

Where there is a furnished letting, the income derived from it would fall under Schedule D, Case VI (see ICTA 1988, s.18(3)). ICTA 1988, s.505(1)(a) specifically exempts charity property income assessable under Schedule A or Schedule D, so far as it is applied to charitable purposes. In cases where accommodation is let and not only is it furnished but services are provided as well, e.g., if a university lets its bedrooms and provides laundry services and meals, the income becomes trading income (as in, e.g., a hotel trade) and is liable to tax.

HMRC's guidance explains

“All rental income from land or buildings, received by a charity, is exempt from tax provided the profits arising are applied for charitable purposes.

“However, if services are provided along with the use of the land or buildings (for example, provision of a caretaker, food or laundry) these services in themselves might amount to trading. Letting activity will itself constitute a trade where the owner remains in occupation of the property and provides services over and above those usually provided by a landlord. Essentially the distinction lies between the hotelier (who is carrying on a trade) and the provider of furnished accommodation (who is not). An important difference is that in a hotel etc. the occupier of the room does not acquire any legal interest in the property. Each case must be considered on its own facts.”

The VAT rules of letting are more complex – in essence the charity may opt to tax, that is it may charge VAT on its rental income. The correct answer for the charity will require consideration of a number of factors and is not within the scope of this guidance note.

Property sales

Generally gains arising from the sale of property would call within the exemption found in Section 256 of the Taxable and Chargeable Gains Act but there is a need to be aware of another pitfall.

Charity trustees are required to obtain the best terms when disposing of charity property. This can often have tax ramifications and may cause tax problems. For example, it may be the best commercial decision to obtain planning consent before disposing of a property and, taking this one step further, the charity may plan to develop the property.

After considering the investment powers of the trustees and whether investing in development activity would be speculative and correct for the charity to undertake, there is a further question of whether the development profits would be taxable as trading.

S776 ICTA 88 was enacted to prevent the avoidance of tax by persons concerned with land or the development of land. The section will apply when land is acquired or developed with the intention of realizing a capital gain from the disposal. In these circumstances the profits or gains are chargeable to tax under Case VI of Schedule D and would not usually fall within the primary purpose trading exemptions exemption of s505 of ICTA 88.

The law is far-reaching and explains that “where, whether by a premature sale or otherwise, a person directly or indirectly transmits the opportunity of making a gain to another person, that other person's gain is obtained for him by the first-mentioned person.”

Care must be taken with such transactions to ensure that the charity is not in breach of its investment powers or exposed to tax. Often the safest route is to use a separate trading subsidiary. However, the charity cannot gratuitously give away assets or rights to its trading subsidiaries and transactions will need to be on an arm's-length basis.

Lotteries

Charities do not have to pay tax on profits from lotteries run to raise funds for their charitable purposes if the lotteries are promoted and conducted under a license issued under section 98 of the Gambling Act 2005 or Article 133 or 135 of the Betting, Gaming, Lotteries and Amusements (Northern Ireland) Order 1985. There is the overall requirement that the lottery profits are applied solely to the purposes of the charity.

In some cases a subsidiary company may be registered as “the Society” under the legislation. In such cases, the lottery profits will belong to the company and not to the charity for tax purposes. The exemption will not apply and the company will need to pass the profits to the charity as discussed further in this guidance note.

The Finance Act 2006 made changes to primary legislation but maintains the existing exemption from tax for charities for the profits from charitable lotteries run in accordance with lottery regulations.

Earlier the exemptions were given by section 505(1)(f) ICTA 1988) by reference to the Lotteries and Amusements Act 1976. The relevant sections of the 1976 Act have been replaced by sections of the Gambling Act 2005. The 2005 Act also brings in a new regulatory framework for lotteries. The Finance Act 2006 ensures that only lotteries which are lawful under the 2005 Act receive tax relief, but does not extend or restrict the existing relief. These amendments were

brought into force to coincide with the introduction of the new licensing regime under the 2005 Act, on 1 September 2007.

Changes to tax law in the Income Tax Act 2007 (ITA 2007) separate charitable trusts from charitable companies, so that section 505(1)(f) ICTA 1988 will only apply to charitable companies. The legislation also amends the law to ensure that charitable trusts continue to receive the relief.

For VAT purposes a lottery is the distribution of prizes by chance where the persons taking part in the operation, or a substantial number of them, make a payment or consideration in return for obtaining their chance of a prize. The right to take part in a lottery is exempt under VAT Act 1994, Sched. 9, Group 4, Item 2. The value of the exempt supply is the gross proceeds from ticket sales less only the amount of cash prizes given or the cost, including VAT, of goods given as prizes. However, where an element of merit or skill is introduced the event is not a lottery but a competition and VAT rules for sports competitions will apply.

The 2005 Act brings in a new licensing regime for some large lotteries. Where this licensing regime applies, relief will not be given for lotteries which do not have the required license, as the lottery would be unlawful.

Overseas operations

Many charities trade overseas and in addition to the UK laws and regulations there are local laws to consider. UK statutory exemptions discussed above will apply for UK tax purposes even if the trade is carried out overseas.

However, local tax law will in the overseas regime not automatically allow the same concessions and exemptions as apply in the UK. Charities have found that they face local tax liabilities because the exemptions do not work in the same way as they do in the UK. In many overseas regimes the concept of charity as it is in UK is not recognized and simply setting up an operation overseas can lead to the creation of a permanent establishment for tax purposes.

In some cases it may be better to trade through the UK operation but even if this does not create a taxable presence overseas there could be withholding tax. These taxes usually apply if there is an activity that involves the payment of royalties and dividends. Withholding tax can often be mitigated or avoided altogether through the application of relevant double tax treaties.

In some cases it may be possible to use one overseas establishment in a favorable tax regime to cover operations in different countries.

3. TRADING SUBSIDIARIES

Trading subsidiaries—The answer?

As we have seen, charities are now increasingly exposed to the implications of trading. Some of the areas of exposure are new but the issues have been around and discussed for a long time. In their 1980 report the Charity Commissioners stated that drawing the line between the charity which is merely raising funds and furthering its activities by trading and what is in substance a trading institution wearing a charitable mantle is not easy. They went on to say that where a charity wishes to benefit substantially from permanent trading for the purpose of fundraising it should do so through a separate non charitable trading company so that its charitable status is not endangered.

Essentially, trading through a separate trading company has a number of benefits. It is encouraged under charity law, it is possible to arrange matters so that all the profit is transferred to the parent charity in a tax efficient manner and if properly structured the trading subsidiary will be a separate entity with limited liability. However, care must be taken to ensure that all the detail is fully considered so that none of the potential benefits are lost.

Setting up and financing the trading company

It is usual for a trading company to be owned by the charity.

The trading company will usually require working capital that could be made available by any of the following ways:

- borrowing from a commercial source
- borrowing from the charity
- issue of share capital

When it comes to financing or refinancing the trading company there seems to be a slight difference of opinion between HMRC and the Charity Commission. HMRC have stated “Most commercial companies use their profits to maintain and develop their business. If a company intends to distribute all of its profits every year, this may leave it without these necessary funds. To avoid this problem, when a charity sets up a trading company, it should ensure that it provides the company with enough capital to enable it to shed its profits every year and stay in business.”

The Charity Commission’s old guidance stated, “Normally, investment in a subsidiary trading company should take the form of secured loans by the charity on market terms. Charities should not ordinarily subscribe anything more than nominal sums for the issue of share capital by the subsidiary trading company (in order to satisfy the formal requirements of company law). The subscription of shares in the subsidiary trading company by the charity normally exposes the charity's investment to greater risk (because the repayment of share capital, in the event of the liquidation of the subsidiary trading company, has a lower priority than the repayment of loans).

My experience is that some responses from the Commission still seem to focus on this old guidance. It is therefore important to recognize that the Commission appear to have taken a more reasoned approach to financing of trading subsidiaries in their new guidance which explains:

However, there are valid reasons why a parent charity might choose to capitalize a trading subsidiary by means of share capital rather than loan capital. For example:

- the subscription by a parent charity of substantial share capital in its trading subsidiary can give confidence to suppliers, customers, creditors, prospective creditors and others with whom the trading subsidiary has a business relationship; or
- where a trading subsidiary would be exposed to the risk or actuality of insolvency if it were to be capitalized by loan, trustees will have little choice but to invest share capital (subject to the considerations set out in section D8 of the CC35 guidance, above).

The fact that share capital subscribed by the parent charity in a trading subsidiary might not be repaid in full, or even in part, on the dissolution of the subsidiary, is only one factor which the charity's investment adviser should consider when deciding whether to recommend the trustees of the parent charity to subscribe for share capital. The adviser would have to consider the overall economic return to the charity, balancing Gift Aid payments and any anticipated distributions against the risk of capital loss.

In their guidance on investing in a trading subsidiary the Commission and HMRC have explained that they would expect the charity to consider carefully issues such as the:

- investment powers of the charity
- need to diversify investments
- risk profile of the trading activity
- financial viability and business prospects of the subsidiary
- suitability of the investment

In all cases it must be seen that making the investment is expedient in the interest of the charity.

In the past the Commission also stated that if funds are needed to sustain or expand the activities of the trading company they should normally be obtained from commercial sources. There are however many problems with obtaining money from a commercial lender who will almost certainly want a guarantee from the charity.

In the first instance the charity must have the constitutional powers to give such a guarantee. As a general rule it is a fundamental tenet of charity law that the charity should not give away its own assets except in the furtherance of its charitable purposes. The giving of a gratuitous guarantee of this nature could be tantamount to giving away assets if the guarantee was called. However case law has shown that in certain cases the giving of such a guarantee would be within the powers of a corporate charity but this would only apply if the company on whose behalf the guarantee was given was a wholly owned subsidiary of the charity and was carrying out the objects of the charity. The first condition is not difficult to achieve but the second may be a stumbling block.

At any rate, the Charity Commissioners would look very closely at any guarantees given on behalf of a trading subsidiary. They have explained that "Such guarantees, if given, will often be unenforceable against the charity and may expose trustees to personal liability."

Furthermore, I do not think that it is always a sound financial decision to obtain external funding. It seems pointless if the trading subsidiary is paying external interest at a rate above that which the charity may be obtaining on money it has invested. The route followed by most charities with trading subsidiaries is to finance internally. If there is going to be a need for a fixed amount of working capital it is perhaps better to provide this through the issue of share capital.

As discussed above the charity's trustees must consider two questions when considering investment in subsidiary companies. These are:

- does the charity have the wide investment powers to make such an investment; and
- is a trading venture of this sort too speculative and risky for the charity?

The first of the above conditions would require scrutiny of the constitution, and if necessary the widening of the investment powers given to the Trustees.

The second question is more subjective—trustees should not make hazardous or speculative investments. The general rule that a trustee should act as an ordinary prudent man of business was expanded in *Learoyd v Whiteley* (1883) when Lord Watson said: “Businessmen of ordinary prudence may, and frequently do, select investments which are more or less of a speculative nature: but it is the duty of a trustee to confine himself to the class of investment which are permitted by the Trust and likewise to avoid all investments of that class which are attendant with hazard.”

Therefore, it is important that there is adequate evidence that the trustees have carefully considered their investment. There should be business plans and forecasts to show the expected return on the investment. Additionally, it is important that the trustees show that they regularly reconsider the appropriateness of their investment in the trading subsidiary. In my opinion the trustees should, at least each year, formally minute that they have reviewed the trading operation and considered whether it is appropriate to continue to invest in it.

In their latest guidance on Trading the Charity Commission have explained that:

- the trustees must reasonably consider that it is in the charity's interests to make the investment, after making a fair comparison of this form of investment with other forms of investment which might be selected;
- this fair comparison must involve an objective assessment of the trading subsidiary 's business prospects;
- the trustees must be satisfied as to the financial viability of the trading subsidiary, based on its business plan, cash flow forecasts, profit projections, risk analysis and other available information; and
- the trustees must ordinarily take appropriate advice on the investment, and the financial viability of the trading subsidiary. What is “appropriate” will depend on the circumstances: the cost of taking the advice is a relevant factor, and the cost should be commensurate to the size of the proposed investment.”

Schedule 20 ICTA 1988

Furthermore, in 1986 various provisions were introduced which are now enshrined in Section 506 of the Taxes Act 1988. These provisions broadly state that the charity could lose tax exemption already obtained if it incurs expenditure which is non qualifying. (Now termed non charitable expenditure). Charitable expenditure includes the list of qualifying investments and qualifying loans contained in part 1 and part 2 of schedule 20 to the Taxes Act.

Unfortunately, that list does not include investment in or loans to subsidiary companies. There is, however, a provision that a charity can make a claim to the HMRC to treat such loans or investments as qualifying but it should be clear that they are made for the benefit of the charity and not for avoidance of tax.

Regrettably, the law does not provide any prior approval procedures and normally the claim can only be made after the charity has completed the investment or loan. Both HMRC and the Commissioners expect the transactions with the trading subsidiary to be on an arms-length basis. That is to say the investment stands up to commercial scrutiny. This will be tested in the case of a loan by the rate of interest payable, the terms of repayment and security. Any transactions between the parent and subsidiary should be at arm's length and no extended credit should be provided. In the case of share capital the trustees should be able to demonstrate that the investment is not speculative by considering the profitability of the trading subsidiary.

In their guidance to charities, HMRC has explained:

Charities which own companies set up to carry on non-exempt trading activities will usually need to consider investing funds in the company when the company is set up. The company may also need injections of money to fund expansion or development of its business after it has been established.

There are special rules in the Taxes Acts that apply to investment of a charity's funds in a trading company. If these rules are not followed the charity will risk losing some or all of its tax exemptions. To qualify for relief an investment must be made:

- for charitable purposes only
- for the benefit of the charity, and
- not for the avoidance of tax.

Investments will be regarded as made for charitable purposes and for the benefit of the charity if they are commercially sound. Usually, charities should ensure that investments are secure, carry a fair rate of return (actually paid) and, in the case of loans, provide for recovery of the amount invested in due course.

They go on to explain:

When looking at the qualifying expenditure of a charity we not only consider the direct charitable payments a charity makes, but also the nature of the investments and/or loans made by the charity.

Schedule 20 to the Income and Corporation Taxes Act 1988 describes the types of investments and loans that the Inland Revenue accept as qualifying investments and loans. An investment or loan which is not accepted as falling within one of the definitions mentioned will be regarded as non-qualifying expenditure.

If a loan is not an investment it will be a qualifying loan if it is:

- a loan made to another charity for charitable purposes only;
- a loan to a beneficiary of the charity, and made in the course of carrying out the purposes of the charity;
- money placed in a current account at a bank; or
- any other loan made for the benefit of the charity, and not for the avoidance of tax.

An investment or loan will normally be “for the benefit of the charity” where it is made on sound commercial terms. Whether or not an investment or loan is commercially sound should be considered by reference to the circumstances prevailing at the time it was made.

There is no one test of commercial soundness, and each case must be viewed on its own facts.

Where a loan or investment:

- carries a commercial rate of interest; and
- is adequately secured; and
- is made under a formal written agreement which includes reasonable repayment terms

We will normally accept that the investment or loan is for the benefit of the charity.

Many charities have subsidiary companies that pass their taxable profits to the parent charity. Where an investment is made in, or loan to, such a subsidiary company, the charity is unlikely to be able to obtain normal security for the investment or loan. In such cases we may ask to see the business plans, cash-flow forecasts and other business projections which informed the charity's decision to make the investment or loan.

I am often asked if a claim to HMRC must specifically be made – the answer is that if the charity believes that they have incurred non charitable expenditure then they would need to disclose this In their guidance notes on the Charity tax return form HMRC state

Investments and loans within Schedule 20 ICTA 1988

Qualifying investments for the purposes of Section 506 ICTA 1988 are specified in Part I, Schedule 20 ICTA 1988. Qualifying loans for the purposes of Section 506 ICTA 1988 are specified in Part II, Schedule 20 ICTA 1988.

Any loan or other investment not specified may be accepted where the charity makes a claim to HM Revenue & Customs Charities for it to be treated as qualifying, and the loan or other investment is made for the benefit of the charity and not for the avoidance of tax (whether by the charity or any other person). If HM Revenue & Customs Charities cannot agree the claim, you have the right of appeal to the Special Commissioners. If the charity has made a loan or investment in the period that it thinks is qualifying, for which a claim is required and for which no claim has been made, you should submit a claim with the Return.

Alternatively, you should provide a computation of restriction of the relief under Section 506(3) ICTA 1988. Any claim made for this purpose should give sufficient details of the loan or investment in question for us to be able to understand its nature and should indicate which paragraph of Schedule 20 it is made under.

Investments and loans made outside Schedule 20 ICTA 1988

If the charity has made any investments or loans which do not fall within Schedule 20 ICTA 1988 and no claim is to be made with this Return, enter the total of such loans or investments in box 7.38.

HMRC have also provided detailed guidance on their website which explains the Reporting Requirements.

Where a charity receives a tax return

If a charity is satisfied that all of its investments or loans fall within the categories listed at Sections I paragraphs 2 – 8 or Section II paragraphs 10 (1) (a) to (c) of Schedule 20 it should tick the box on their tax return as follows:

- Company return box E26 of the charity supplementary page (CT600E);
- Trust Return the question about qualifying investments on the charity supplementary page (SA 907).

The charity need do nothing more.

If the charity is satisfied that any other loan or investment, not falling within the relevant paragraphs of Sections I or II of Schedule 20, still qualifies because: it is made for the benefit of the charity and not for avoidance of tax; there are two options: tick the box on the appropriate return page (as above) and be prepared to make a formal claim in respect of the relevant investment if requested by HMRC Charities; make a formal claim with the return, or separately.

No tax return received

A formal claim for determination of whether a loan qualifies can be made at any time after a loan or investment has been entered into. HMRC cannot make a determination about whether the loan or investment qualifies before an investment/loan arrangement is made.

Claims

Where a charity wants to make a formal claim or if a formal claim is requested by HMRC charities that claim must be in writing and must specify:

- the nature of the investment (loan, shares etc);
- the amount involved;
- the accounting period in which the loan or investment was made;
- whether the claim is made under paragraph 9 or 10 of Schedule 20.

It is also helpful if any other relevant information is supplied at the time of the claim, e.g. details of the terms of a loan.

Loans or investments outside Schedule 20

Where a charity has entered into investments or loan arrangements which do not satisfy the requirements of Schedule 20 the total of such loans or investments must be entered at: Box E27 of the charity supplementary pages to the CT return or, Box 7.38 of the charity supplementary page to the Trust return.

4. PROFIT SHEDDING

Profit Shedding

In order to avoid a tax charge the trading company must use a tax effective method of transferring its profits from itself to the parent charity. There have been three time honoured methods for doing this:

- Variable Deed of Covenant;
- Gift Aid; and
- Dividends.

Deeds of Covenant

Some charities continue to make payments under Deed of Covenant but the rules are now similar to the Gift Aid rules. A payment under a deed of covenant is a charge on income. In essence, this means that if a company makes a profit and properly covenants all of its profit to a charity there will be no tax charge.

Where the company is wholly owned by the charity, for the payments after 1 April 1997, the payment can be made up to nine months after the end of the accounting period. This saves the “gives, pay and repay” charade which had been necessary.

Gift Aid

The Gift Aid regime is much simpler than that for a deed of covenant in that the deed must be properly drawn up and properly executed so that it is legally binding. With Gift Aid, once the money has been given the actual procedure for reclaiming the tax can be completed subsequently. However, the rules are precise and no refund can be permitted.

The gross amount of the payment is allowed as a deduction against the company’s profits for corporation tax purposes for the accounting period in which the payment is made. The option to make the payment up to nine months after the end of the accounting period is available to trading subsidiaries that are wholly owned by charities.

Dividends

The subsidiary can of course elect to pay its profits to the charity using dividends. This method should only be used if the subsidiary has not used the covenant or gift aid route and it has to pay tax on its taxable profits.

From 6 April 1999 Advance Corporation Tax was abolished but there are transitional provisions for charities and the tax credit recoverable was reduced over 6 years to zero by 6 April 2004. This means that the charity will now not be able to recover the tax on the dividends. There is also anti avoidance legislation which imposes a tax liability when dividends are paid out of pre-acquisition profits. However, this does not apply in most cases since charities do not often buy subsidiaries that have pre-acquisition profits.

Choice of Method

In my opinion either the covenant / gift aid route is the most suitable although it does require that the covenant is properly set up and execute—an overpaid covenant can be repaid.

Some charities wrongly believe that to show the viability of the investment in the subsidiary there should be a dividend stream. Consequently, they have been using the dividend route even when it leads to a loss of tax. The viability of the investment is measured by the return to the charity and the method of transferring profits is not really relevant. Apart from the tax rate issue already discussed the dividend, if it is paid before the year end, suffers from the same problems of estimating the profits. If it is paid after the year end then there will be cash flow disadvantages since the advance corporation tax in respect of the dividend cannot be used to offset the mainstream corporation tax liability until the following year's tax liabilities have been agreed.

Does the Gift Aid have to be paid?

A trading company that is wholly owned by a charity or charities has up to 9 month after its year end to make the payment. Regrettably, I continue to see cases where management have forgotten to make the Payne tin time and this exposes the trading subsidiary to a tax liability.

There are some issue to consider that might mitigate the situation. I sometimes see cases where a charity and its subsidiary operate intercompany accounts in the accounting records with each making payments on behalf of the other (e.g., one invoice may cover both the charity and the trading company).

This often leads to the position that the Gift Aid payment from the trading subsidiary has not been paid by an exchange of checks or transfers between bank accounts but is discharged through the intercompany account. This is not seen to be the favored option as the Gift Aid rules refer to a payment of a sum of money and I have seen HMRC be concerned about this in the past.

However, they appear to be more open to discussion on this and in correspondence with me they have stated:

Following a very recent Solicitors' Opinion on a similar matter we have reconsidered our view on what constitutes a "payment of a sum of money" in certain circumstances.

We now take the view that, where a wholly owned trading company makes payments on behalf of its parent charity (for example, one invoice may cover both the charity and the trading company) and an intercompany account is in operation, the trading company can make Gift Aid payments by discharge through the intercompany account. That is, we regard the discharge of the debt owed to the trading company as a "payment of a sum of money" at the time the discharge is made – if the discharge is within the 9 month period then the Gift Aid payment can be carried back to an earlier accounting period.

The above view has not been tested and, to avoid doubt, the best course of action remains for the trading company to physically make a payment from its own bank account to the charity.

It is important to appreciate that this does not mean that the Gift Aid can simply be discharged by creating a liability through the inter company account. HMRC appear to be allowing a situation where the subsidiary is owed something from the charity and then the liability is cancelled by the use of the inter company account for payment.

My view is that, although I have put cases to HMRC on the basis of the above stated guidance and they have been accepted, this route could be open to challenge and that it is best to make the payment from the subsidiary to the charity.

Deducting the tax

Prior to 1 April 2000 companies had to deduct basic rate tax from the covenanted or Gift Aid amount paying over the net amount to the charity. There is no longer a need to do this and the gross amount is paid to the charity.

Comparison of Taxable and Accounting Profits

Since the trading company pays up the taxable profit there may be a complication where the taxable profit differs from the accounting profit. This is likely to occur for a number of reasons. Most commonly, where the subsidiary has fixed assets, the depreciation charged in arriving at the accounts profit is different from the capital allowances given in calculating the taxable profit. Similarly, there may be other items of expenditure in the trading subsidiary such as entertaining that may be disallowed for tax purposes.

As a consequence the taxable profit may be larger than the accounts profit and since the aim is to transfer the taxable profit this would result in a negative Profit and Loss Reserve. Negative Profit and Loss reserves may become a problem particularly where there is an overall negative net assets position as the trading company may be insolvent under a balance sheet test.

This creates unnecessary complications and I generally prefer the situation where the accounting and taxable profits are not different so if the subsidiary is profitable and sheds all its profits there should be no negative Profit and Loss Reserve.

I see a number of situations where the subsidiary is profitable but may still wind up with negative reserves. This usually happens where depreciation as calculated for accounting purposes is more than the capital allowances deducted for tax purposes. In such cases the accounting profit is lower than the taxable profit and if the subsidiary Gift Aids up the taxable profit this could lead to overall negative reserves. Therefore I generally try to avoid situations where the taxable and accounting profits are different and recommend that charity owns all the fixed assets and makes an appropriate charge to the subsidiary for their use.

Negative reserves and Gift Aid payments

Negative reserves will usually mean that the subsidiary will not have any distributable reserves and this may cause problems. The definition of a "distribution" in Section 263 of the Companies Act 1985 is extremely wide and is defined to include "Every description of distribution of a company's assets to its members in cash or otherwise." The exceptions that are listed would not really apply in typical cases. Therefore there has been concern that a Gift Aid payment made when there are negative reserves would be an illegal distribution.

This issue does need to be carefully addressed in each situation to establish a satisfactory solution. We have discussed this with the Charity Commission and a senior lawyer at the Commission has clarified as follows:

My view is that if a gift is made in furtherance of the declared objects of the company, it is not a "distribution" for the purpose of section 263, and can be made out of a company's subscribed capital, if the company's objects authorize this. A charity trading company typically will have an object directed towards the support of the charity which

owns it. An ordinary commercial company would not, ordinarily, have a comparable object.

I am aware of three cases which are regarded as authority for the gifts are “distributions” argument. But the cases all concern applications of company property which were *not* authorized by the objects of the companies concerned. None is a charity case.

The payments which had been made by the companies in *Ridge Securities v IRC* (1964) 1 WLR 179 were dressed up as loan interest for the purposes of a tax avoidance scheme, but were, in fact, regarded by the court as gratuitous payments, which were not authorized by the paying companies' objects.

In *Re Halt Garage* (1964) Ltd (1982) 3 All ER 1016 payments had been made to two directors under a corporate object which made provision for remunerating them, but the court decided that the object could not be relied upon as authority for payments which could not reasonably be described as “remuneration” at all.

In *Aveling-Barford Ltd V Perion Ltd* (1989) BCLC 627, the company had the power to sell land, but no explicit power to sell at an undervalue (which is what it did), and no implied power to sell at an undervalue where the purpose of the sale was to effect an unauthorized return of capital to a shareholder, and thereby reduce the assets available to creditors in the insolvent liquidation which ensued. That transaction was again treated as *ultra vires*.

The judges in these cases made observations in them to the effect that companies could not *intra vires* make non-commercial payments, unless they were dividends made out of accumulated profits, or were authorized reductions of capital. But the judges' observations have to be taken in the context of considering corporate objects which were of a wholly commercial nature, and which did not, in fact, permit the making of gratuitous payments, where there was no commercial purpose.

The position where the objects of a company did permit the making of gratuitous payments - notwithstanding the absence a commercial purpose - was considered by the Court of Appeal in the case of *re Horsley and Weight Ltd* (1982) Ch 442. This is the case which I mentioned at the meeting at the Home Office at which the proposed version of CC35 was discussed.

In that case, payments were made for the benefit of a director in pursuance of an object of the company which explicitly permitted this. The liquidator of the company claimed that the payments were *ultra vires* because of the perceived lack of commercial justification. The response of Buckley J was—“The objects of a company do not need to be commercial; they can be charitable or philanthropic, indeed they can be whatever the original incorporators wish, provided that they are legal. Nor is here any reason why a company should not part with its finds gratuitously, or for non-commercial reasons, if to do so is within its declared objects.”

As the judge pointed out in the *Aveling-Barford* case, the purpose of Part VIII of the Companies Act 1985 is to protect creditors from the unauthorized return of capital to members. But the subscribed capital of a company can be applied towards the furtherance of its objects: that is what it is there for. If the objects explicitly permit the company to

apply its assets non-commercially, then creditors can hardly regard themselves as being unfairly treated if it does so.

Of course, any gratuitous transaction of a company is potentially capable of being recalled under section 238 Insolvency Act 1986, whether the transaction is constitutionally authorized or not. And, in an insolvency situation, the directors of a company can be made liable to make payments to the company for the benefit of its creditors if they conduct its business, even in a way which is in terms authorized by the company's objects, so as deliberately (s213) or negligently/recklessly (s214) to cause unnecessary damage to creditor interests. But these considerations are not, in my view, relevant to the question whether a payment by a company is or is not a "distribution."

This view has been reinforced in CC 35 The Charity Commission's guidance on trading. In it they specifically address the question: "Can a trading subsidiary pay more to its parent charity in Gift Aid than the level of trading profits (in accounting terms) which it has earned?"

The short answer

Yes. This issue will generally arise when the trading subsidiary's level of trading profits for tax purposes is greater than its level of profits for accounting purposes. Any tax liability will depend on the level of taxable profits. If that liability is to be eliminated entirely, the whole of the taxable profits will have to be paid to the charity, even if that is greater than the profits for accounting purposes. The balance will, in most cases, need to be financed out of share capital, since the trading subsidiary is otherwise likely to be insolvent.

In more detail

If a trading subsidiary earns, in an accounting period, taxable profits in excess of its profits for accounting purposes, it may pay to its parent charity a greater sum in Gift Aid than it has profits for accounting purposes, in order to eliminate its corporation tax liability. As a result, all or part of the Gift Aid payment may be made out of the company's subscribed share capital, including any share premium account.

Although there are differences of legal opinion on this issue, it is considered that such Gift Aid payments may be made out of the trading subsidiary's subscribed share capital, provided that the objects of the trading subsidiary authorise such gifts. The parent charity can, by subscribing additional share capital in the trading subsidiary, enable the subsidiary to do this, without making the subsidiary insolvent.

It is possible that the trading subsidiary may prefer to acquire the resources needed to make the full Gift Aid payment out of funds borrowed from the parent charity. However HMRC Charities take a critical view of any apparently circular arrangements. Parent charities and their trading subsidiaries contemplating such a course of action should take professional advice, and take into account the investment propriety and insolvency issues.

It is worth recognizing that subsidiary may have a negative reserves at the balance sheet date but a subsidiary that are wholly owned by a charity has up to 9 months after its year end to make the Gift Aid payment and by that time it will have earned more profit which may mean that there is no negative reserve at the time of the payment.

Additionally, a charity can allocate a notional charge for goods and services supplied to it at undervalue. This could include volunteer time and reduced rates for professional fees.

A question of interest

The Charity Commission and HMRC consider that loans from charities to their trading subsidiaries should be on commercial terms and that charities should charge interest to these trading subsidiaries.

The “War on Want” enquiry several years ago spotlighted this issue. The enquiry found that advances to finance the trading company were not at arms length and said that if they were not repaid with interest they represented an application of charitable funds for non charitable purposes. They went on to recommend that if repayment was not possible, consideration should be given for an action under Section 28(7) of the Charities Act 1960 for recovery from the members of the Council of Management.

Capital gains and Gift Aid

The exemption from capital gains tax which is given by virtue of Section 256 of the Capital Gains Tax Act 1992 (if the gain is used for charitable purposes) is available only to the charity and not the subsidiary.

Of course the trading subsidiary may dispose of its own property or other assets and make capital gains. The subsidiary can deduct Gift Aid payments from total profits, which includes chargeable gains as well as all other income.

5. OPERATING AT “ARM’S LENGTH”

The general principle is that a charity and its trading subsidiary should operate at arm’s length and there are some “rules” that need to be followed. However, there is a risk that structures are over engineered unnecessarily. There is no need to reinvent the wheel and there are trusted and tried models that operate successfully which have been accepted by the regulators..

Liabilities and losses of the trading subsidiary

Not all trading companies are profitable. In fact, there have been incidents where trading subsidiaries have gone bust whilst owing considerable amounts of money. The Charity Commissioners addressed this matter in their 1988 report which referred to the liquidation’s of Search 88 & Co Limited owing £700,000 and Sports Aid Limited owing £2-£3 million. In both these cases the charity trustees and promoters followed sound and recommended advice in order to protect the assets of the Charities.

In one of these cases the creditors thought that they were dealing with the charity rather than an arms length limited liability company. It is vital that it is made clear to those involved as to whether the transactions are with the charity or its subsidiary.

Failed subsidiaries often leave the charity’s trustees in a dilemma. In order to avoid the adverse publicity which may arise and because of a perceived moral obligation to the creditors, they may wish to settle the liabilities of the trading subsidiary. Such a course of action would normally be outside the trustees’ powers.

Whilst talking about subsidiaries failing it is worth mentioning that it is possible that directors of a trading subsidiary could be guilty of wrongful trading under Section 214 of the Insolvency Act. When a subsidiary is making losses there is perhaps a tendency to expect better

times. Directors should act with extreme caution and when there appears to be no reasonable prospect of avoiding liquidation there is a need to take immediate steps to minimize the loss to creditors.

A director is expected to conform to an objective standard of ability and should be aware of the current position of the company. A director may be personally liable if the company is allowed to continue trading when it is effectively insolvent. Similarly, the charity's trustees may be personally liable if they continue to prop up a failing subsidiary by lending it charitable funds.

HMRC will also look at a loss making trading subsidiary to consider whether the charity by funding it is incurring non charitable expenditure that could jeopardize its tax exemptions. Previously they took the view that they would exclude notional charges and indirect cost allocations when considering this. Similarly in the past they disregarded the element of the loss that is created by the allocation of fixed costs if it can be shown that the charity would have incurred that expenditure in any case. However this view appears to have changed – see the section on management charges and cost allocations.

It is important to recognize that if the trading subsidiary is carrying out activities that further the primary purpose of the charity then losses made by it even if they are subsidized by loans or grants from the charity will not be non charitable expenditure. In essence, the charity would have to be able to show that it could have incurred the expenditure that created the loss.

Management charges and cost allocations

Many charities and their trading subsidiaries operate from the same premises and may use joint facilities such as staff, communication services, computer system etc. In fact many trading subsidiaries do not have any staff or facilities of their own.

In most cases the charity's facilities are used by the trading subsidiary and following the arms length principle the charity should levy a fair and reasonable charge. VAT should be accounted for on these charges if the charity is registered for VAT and there is no group Vat election. In fact this can usually work to the organization's advantage.

Many charities are not registered or are partially exempt for VAT, consequently they cannot reclaim all their input VAT. It is not always fully appreciated that the unrecoverable element may decrease proportionally as taxable supplies increase.

Depending on its VAT recovery methodology it is often beneficial for a charity to try and increase their taxable outputs especially when the supply is to a "person" who can recover the VAT charged. Therefore, by accounting for management charges with VAT the charity may indirectly increase the amount of input VAT it can recover. Of course, the trading subsidiary should be able to recover all the input VAT.

The allocation of costs should include both direct and indirect overheads. It is important to ensure that the management charges are a fair calculation and only amount to a reimbursement since any profit element could perhaps be regarded as a trading receipt which would not normally fall within the trading exemptions. Alternatively, HMRC may seek to disallow any excessive amounts in the subsidiary company's tax computations as not being wholly and exclusively expended for trading purposes.

Following the Finance Act 2006 and the changes to the trading exemptions found in Section 505 ICTA '88 HMRC have published new guidance. This explains that, trading receipts should be allocated between trades that are taxable and non taxable on a reasonable basis.

HMRC clarify that the profits of taxable non-primary purpose trading, including capital allowances if applicable, should be calculated in the same way as for any other trader. They emphasize that "This may involve apportioning what was originally charitable primary purpose expenditure to a non- primary purpose or deemed non-primary purpose trade. Any such apportionment will only apply for tax purposes."

HMRC has placed much more importance on cost allocation and they state,

For most charities the challenge will be to maintain adequate accounting systems to properly identify the separate primary purpose and non-primary purpose deemed trades, to allocate and where necessary apportion costs to each. Charities are strongly recommended to do this. The approach may vary. For example, there could be a "high level" approach of identifying the trading activity of a particular department, division or building, etc. as primary or non-primary purpose. Alternatively, there might be a "middle level" approach of, for example, identifying particular contracts or projects, or the work of individuals as primary or non-primary purpose. At the most detailed level, charities might identify each individual piece of work done, flag it primary purpose or non-primary purpose in the accounting system, and allocate costs accordingly

HMRC's view is that a high or medium level approach may be justified on the facts – a department or a project may be identifiable as wholly primary purpose or wholly non-primary purpose. However, this approach would be inappropriate for mixed primary/ non-primary purpose activity. In HMRC's view, a "low level" approach to accounting for primary and non-primary purpose activity will be more appropriate. This will give the greatest accuracy and take the least risks with charity law, which places a responsibility on trustees to identify non-primary purpose trading carried on by the charity for which they bear responsibility."

HMRC has gone into much detail about cost allocation and stress that for a non-primary purpose deemed or part-beneficiary trade, the new legislation now requires that there be a "reasonable apportionment of expenses and receipts." They explain that in their view this will involve taking into account direct expenditure and a reasonable proportion of indirect expenditure such as overheads, whether or not these were originally incurred for charitable purposes.

They have provided the following guidance to illustrate what they would expect:

If a non-primary purpose trading activity is the charity's only trading activity, is carried on in the charity's premises and takes 30% of the floor area, it might be proper to allocate to the non primary purpose trade 30% of the costs of the premises such as:

- heat and light
- rent
- building repairs and maintenance.

Apart from the use of premises, other indirect overheads that may be partly attributable to the trade are:

- employee salaries
- computer costs
- telephone charges
- postage costs
- accountancy and legal fees
- general administration.

The proper basis of apportionment of indirect costs will depend on the facts. In the case of the use of premises, the apportionment might be based on:

- the size of floor space allocated to the trade.
- where student accommodation is let to tourists out of term, the number of days in the year when the premises are allocated to the trade, and actively marketed.
- in the case of employee salaries, the amount of employee time devoted to the trade compared to total employee time.

In correspondence with us HMRC have explained:

S505B (ICTA '88 requires that a reasonable apportionment of expenses is made between the primary purpose and non-primary purpose deemed trades created by that section. HMRC does not normally accept a marginal costing basis for the apportionment and looks for an apportionment of all direct and indirect costs. In the higher education sector, for example, the “full economic costing” which is being introduced may often give the right answer.

Cost-sharing with a subsidiary does not normally give rise to problems so long as, on the facts, that is what it is. Again, we would expect all direct and indirect costs to be apportioned on a reasonable basis. If a marginal costing approach is adopted then the charity is incurring indirect costs on behalf of the subsidiary. Those costs may well be non-charitable expenditure.

It is necessary to be clear about whether the charity is dividing costs or providing a service. Many charities find simple division of costs offers the advantage of simplicity. Your example of the computer system is not clear but it seems possible the charity is providing a service. In that case, it is possible that (if the charity is a large enterprise and otherwise within the criteria of INTM 432090) UK-UK transfer pricing may apply. A mark-up may be appropriate, or possibly a charge-rate referenced to conditions obtaining in the open market.

In the past this area of cost allocation between charities and their subsidiaries were not given much importance – the thinking was that it all came out in the wash and if more costs were allocated to the subsidiary the Gift Aid payment back would be smaller and vice versa. This approach is risky.

Loss making trades

This is of particular relevance where a charity is carrying out a non-primary-purpose trade to generate income to contribute towards expenditure. So for example, a charity may use its premises for running training courses which fall within its primary purpose. Spare capacity may be used by the charity for non primary purpose activities or the charity may allow other organizations to run courses on its premises. A full cost recovery situation may mean that in fact the non primary purpose trade is loss making.

If such a trade is carried out by the charity then this could be problematic and potentially lead to income that is taxable. If it is carried out in a trading subsidiary and full cost allocation has to be made then the trading subsidiary may be loss making.

The rules are somewhat complex and convoluted and there is a detailed explanation provided by HMRC in its guidance to the British Universities Finance Directors Group (BUFDG) and I have attempted to paraphrase relevant aspects. However if a charity is in this situation it should refer to the full guidance.

In their guidance for universities HMRC have explained that if the result of the deemed non-primary purpose trade calculated is a loss after adjustment for tax; tax law treats this loss as non-charitable expenditure. Where a charity incurs non-charitable expenditure, it has the following impact:

- Charitable tax exemptions otherwise available against the primary purpose income are restricted;
- The restriction is applied such that for every pound of non-charitable expenditure, one pound of tax exempted income is excluded from tax exemption;
- The restriction removes exemption from charitable income such that it becomes chargeable to tax in the university. This is referred to as “deemed income” and is chargeable to tax.

HMRC have gone on to explain that in certain circumstances a loss on non-primary purpose trading may be offset against the deemed income it creates. Utilizing the loss against deemed income should reduce the chargeable deemed income and taxation liability to nil (see HMRC’s flow chart reproduced at Appendix 1.)

In effect, tax law provides relief for losses arising on trading activities where the trade is carried on a commercial basis and with a view to the realization of gain. To avail of the benefits of this concept the charity would have to show that it passed one of two further tests and if it did the non primary purpose loss should be available to set off (under Section 393[A] ICTA 1988) against the deemed income created by the non-charitable expenditure restriction.

The first test is to confirm whether the deemed non-primary purpose trade is carried on a commercial basis with a view to the realization of a gain. If the non-primary purpose trade loss does not pass this test it is seen to be an “uncommercial” loss and under tax legislation cannot be offset against other income of the same period. This other income would include the deemed income because relief is given only for losses of a trade carried on a commercial basis and with a view to the realization of profit.

However, there is a second statutory test, (the latter part of s. 393A (3) (b) ICTA 1988). If this test is passed it will allow the loss on the non primary purpose trading activities to be offset against the deemed income and reduce the chargeable income to nil.

The basis of the Test = is explained in HMRC's guidance published on their website and set out at CTM04620. This explains that the disallowance of relief for uncommercial losses should not be applied in respect of a loss in a trade which is not itself carried on with a view to the realization of profits where that trade forms a part of a "Larger Undertaking"; and the whole undertaking is carried on with a view to gain.

If the deemed non-primary purpose trade is part of a Larger Undertaking that is carried on with a view to realization of a gain, then losses on the non-primary purpose trade will be allowable even though not in itself a commercial loss.

Regrettably, there is no real definition of a larger undertaking and for the purpose of this test HMRC have explained that, the phrase "Larger Undertaking" is interpreted, for tax purposes, as normally the whole of the charity's trading activities and all its activities, though each case depends on its own facts.

Due to the complex rules and the concern that they cannot be met charities have in the past often channeled such non primary purpose trades through a subsidiary. In the past, a view prevailed which worked on the basis that the charity would have had to incur fixed costs in any case regardless of whether it used its premises for non primary purpose activities. Therefore, only the extra marginal costs were evaluated when considering whether it was worth carrying out the non primary purpose trade to contribute towards total costs. This is probably the right approach from the perspective of whether it is correct for the trustees use the premises to generate additional income.

However HMRC are not ready to accept a marginal costing approach and with the thrust to full cost allocation the trading subsidiary is likely to be loss making with all the attendant concerns that a charity is subsidizing a loss making trade. This unfortunate situation has led to the situation where some charity trustees have decided that it is not worth trying to generate further income from non primary purpose activity. This is not a happy state of affairs and it is hoped that ongoing discussions with the regulators will lead to a satisfactory resolution and a simplification of the rules.

Conflicts of Interest

It is often the case that one or more of the charity's trustees or employees act as directors of the trading company. There are differing views about this. On the one hand there is an argument that this is a good way of ensuring that there is operational control over the subsidiary. Conversely, it is felt that charity trustees' duty to the charity may be in conflict with their duty as directors of the trading subsidiary.

Similarly, some charities use joint employment contracts for their staff who are then employed by both the charity and the trading subsidiaries. In my opinion, there should not be total commonality between the trustees/staff of the charity and the directors/staff of the subsidiary. Whilst some commonality may be advantageous it is imperative that there are procedures in place to ensure that there is no detrimental conflict of interest.

Many subsidiaries have on their board independent directors who have the requisite skill and experience to add value to the subsidiary's business.

Joint VAT Registrations

The issue is that it is sometimes expedient, in the interest of the charity, to have a joint VAT registration with its trading subsidiary. This arrangement can often mitigate the VAT burden for the charity and its subsidiary by allowing enhanced recovery of input VAT and dispensing with a need to charge VAT on intercompany transactions.

However, the taking of such joint registration also means that all parties to the joint registration are liable for any VAT liabilities of each other.

There is a view that this is similar to the charity giving a guarantee on behalf of the trading subsidiary which may result in the charity having to meet the VAT liability of the subsidiary. To my mind, joint registration could perhaps be seen as not giving of a gratuitous guarantee where there is a definite financial benefit to the charity to undertake such a joint registration.

In my opinion, if the trustees have taken sound professional advice that it would be in the financial interests of the group to enter into joint VAT registration then the probability of the trading subsidiary failing and the charity having to meet any VAT liability would be justified.

6. ACCOUNTING FOR TRADING SUBSIDIARIES

This section addresses principally the issues concerning trading subsidiaries of charities established under the Companies Act to carry out “non charitable” or “trading” activities of the charity. Such companies are typically established in order to minimize any direct tax or VAT costs which may arise if those activities were accounted for in the charity. Charities have historically accounted for their trading subsidiaries in a variety of ways.

What is a subsidiary?

The SORP explain,

In relation to a charity, an undertaking is the parent undertaking of another undertaking, called a subsidiary undertaking, where the charity controls the subsidiary. Control requires that the parent can both direct and derive benefit from the subsidiary.

(a) Direction is achieved if the charity or its trustees:

- (i) hold or control the majority of the voting rights, or
- (ii) have the right to appoint or remove a majority of the board of directors or trustees of the subsidiary undertaking, or
- (iii) have the power to exercise, or actually exercise, a dominant influence over the subsidiary undertaking or
- (iv) manage the charity and the subsidiary on a unified basis.

For a fuller definition, reference should be made to sections 258 and 259 Companies Act 1985.

(b) Benefit derived can either be economic benefit that results in a net cash inflow to the charity or can arise through the provision of goods or services to the benefit of the charity or its beneficiaries.

It is important to look at the substance of the arrangement and I have seen cases where controls is achieved even where the above do not apply.

Financial Reporting Standard 2 (FRS2)

FRS2 came into force for accounting periods ending on or after 23 December 1992 and applies to all entities required to prepare financial statements that give a true and fair view, to the extent that the requirements of the FRS are permitted by any statutory framework under which the entity reports. The effect of FRS2 therefore was to introduce a single set of requirements relating to the preparation of consolidated accounts that apply to charities regardless of their constitution.

FRS2 requires exclusion from consolidation in the following circumstances:

- Where there are severe long term restrictions which hinder substantially the exercise of the parent undertakings rights over the subsidiaries undertakings, assets or management; or
- The Group's interest in the subsidiary undertaking is held exclusively with a view to subsequent resale and the subsidiary undertaking has not previously been consolidated; or
- The subsidiary undertaking's activities are so different from those of other undertakings to be included in the consolidation that their inclusion would be incompatible with the obligation to give a true and fair view.

Whereas the Companies Act permits exclusion in cases I and II above, the FRS requires exclusion in such circumstances because the same conditions that justify exclusion also make consolidation inappropriate.

It is worth considering the rationale and principles that underlie the concept of group accounts. FRS 2 defines consolidation as "the process of adjusting and combining financial information from the individual financial statements of a parent undertaking and its subsidiary undertakings to prepare consolidated financial statements that present financial information for the group as a single economic entity." The FRS goes on to explain the purpose of consolidated financial statements, "For a variety of legal, tax and other reasons undertakings generally choose to conduct their activities not through a single legal entity but through several undertakings under the ultimate control of the parent undertaking of that group. For this reason the financial statements of a parent undertaking by itself do not present a full picture of its economic activities or financial position. Consolidated financial statements are required in order to reflect the extended business unit that conducts activities under the control of the parent undertaking."

Clearly the aim of consolidated accounts is to present the activities of the group as "a single economic unit." Therefore it seems appropriate to present the results on the basis of the activity rather than the entity which carries them out. In practice charities may set up subsidiaries to campaign, perform research, fundraise etc. Due to the views of HMRC a number of fund-raising activities that traditionally were carried out by the charity itself and reported in its own accounts are now channeled through a trading subsidiary. These include innovative fund-raising schemes that may involve corporate sponsorship where it could be held that the charity is trading. Similarly, the agreements reached with the tax authorities on charity affinity cards will

mean that an element of the income is deemed to be trading and will have to be channelled through a trading subsidiary.

Different Activities

What does FRS 2 really mean by “activities that are so different”? FRS 2 makes specific reference to not for profit undertakings, stating that the contrast between a “profit” and a “not for profit” undertaking is not sufficient of itself to justify non consolidation.

Many charities hold the view that trading is fundamentally different to charitable activity and that trading activity has no place in a charity’s accounts. However, over the years the distinction between the type of activities that are accounted for in the trading subsidiary and those that are accounted for in the charity has become somewhat blurred. Many charities channel fund-raising activities through the trading subsidiary such as innovative schemes which may involve corporate sponsorship and could be held to be trading. Similarly, the agreements reached with the tax authorities on charity affinity cards mean that an element of the income arising is deemed to be trading and is therefore channeled through the trading subsidiary whilst the remainder is channeled through the charity itself. The sale of donated goods in a charity shop is not considered by the Charity Commission or HMRC to constitute trading and is generally accounted for in the charity whereas the sale of bought in goods, such as Christmas cards in the same shop are accounted for through the trading subsidiary.

Clearly, under the circumstances described above, it would be anomalous that only a percentage of a similar activity is reported in the charity’s accounts.

For example, if a charity receives two corporate donations and one donor has asked for its logo to be used in the acknowledgement then the charity would rightly conclude that this donation should go through the trading subsidiary for tax reasons. Clearly it is anomalous that one donation is shown as a donation with the other netted off in the trading income line. Therefore the Charity SORP advocate a treatment that achieves parity of presentation and disclosure on items that are only artificially segregated due to the tax treatment or other management reasons.

Charity SORP

Some charities were concerned that the consolidation of subsidiaries may adversely affect the ubiquitous cost ratios since the cost of generating income in most merchandising operations is higher than that of raising voluntary or statutory income by the charity. They preferred therefore to relegate the subsidiaries' costs to the notes. This is not acceptable and Paragraphs 393 et seq of SORP 2005 explain the method of consolidation that should be used:

393 The normal rules will apply regarding the method of consolidation, which should be carried out on a line-by-line basis as set out in FRS 2.

394 All items of incoming resources and resources expended should be shown gross after the removal of intra-group transactions. Clearly it is desirable that similar items are treated in the same way. For instance, incoming resources from activities to generate funds in the charity should be combined with similar activities in the subsidiary, and charitable activities within the charity should be combined with similar activities in the subsidiary. Similarly, costs of generating funds and/or governance costs in the subsidiary should be aggregated with those of the charity.

395 Each charity should choose appropriate category headings within the permissible format of the Statement of Financial Activities and suitable amalgamations of activities. The headings used should reflect the underlying activities of the group. If it is not possible to exactly match items between the subsidiary undertaking and the parent charity, segmental information should be provided so that the results of the parent charity and each subsidiary undertaking are transparent.

The effect of consolidation is usually not likely to be very material on the balance sheet but can alter the picture shown on the Income and Expenditure account. There is a fear that important information about the trading subsidiary such as its profitability can be concealed in a consolidated profit and loss account. For example, the fact that a charity may be propping up a loss making subsidiary will not be apparent from a consolidated income and expenditure account. The 2005 SORP recognizes this and requires that where a separate charity only SOFA is not included in the financial statements sufficient information should be provided. In particular, the gross income/turnover and results of the parent charity should be disclosed in the notes and the group accounts must contain the entity balance sheet of the parent charity.

7. CHARITY SHOPS

Many charities operate charity shops, some of these sell only donated goods, some of them sell only bought in goods and some sell a mix of both. Donated goods can be collected house to house and also donated directly at the shops.

Shops owned by subsidiaries

In some cases the shops are operated through the subsidiary and whilst this structure will work. I think there are problems associated with it and it is cumbersome. I usually advise that where most of the goods sold are donated, the shops should be operated through the charity with the trading subsidiary accounting for the new goods and costs associated with those. It might be useful to briefly consider the different types of goods charities sell.

When a charity sells new goods it is trading and unless this trading qualifies for the statutory trading exemptions found in S.505 of ICTA 1988 the profits will be taxable. To qualify the trading should be part of the charity's primary purpose or a trade carried out by the charity's beneficiaries. Additionally, significant non-charitable trading can jeopardize charity status. The circumstances that qualify are limited, for example, if the primary purpose was to relieve poverty then the sale of bought goods at a reduced price to an approved class of beneficiary might qualify or a charity set up to advance religion could sell religious books.

Even here there are special rules and the Charity Commissioners have decided that community shops per se are not charitable. In their 1991 Report they discussed the case of the Community Shop, Leeds, a charity established to relieve poverty by the provision of clothing and other goods at low cost to people in need. The constitution did not preclude the sale of bought in goods and it was not possible to control who bought goods in the shop. The Commissioners considered there was a risk of non-charitable trading and the charity was advised to set up a trading subsidiary to shelter taxable profits which would then be transferred to the charity in a tax effective way.

This has led to some advisors suggesting that charity shops should be operated through a trading subsidiary. However, as explained earlier, neither the Charity Commissioners nor HMRC

treat the sale of donated goods as trading. This endorses my view that donated goods should be sold through the charity and not the trading company.

For VAT purposes there is no special concession and the VAT treatment would follow the type of goods, for example the sales may be standard rated, zero rated or exempt. In particular, the sale by, and the supply to, a charity of donated goods is zero rated.

Previously, this zero rating was only given if the sale was made by a charity and consequently to benefit from the zero rating many charities channeled the income from the sale of donated goods through the charity whilst bought in goods were rightly channeled through a trading subsidiary.

This changed on 1 April 1991 and VAT zero rating on the supply of donated goods now also applies to a “taxable person” who has covenanted by deed to give all the profits of that supply to a charity. These provisions mean that donated goods can be zero rated even if they are sold by a trading company so long as the company concerned covenants the profit of that supply to the charity. Following this change some charities decided that they would channel both the donated goods and bought in goods through the non-charitable trading subsidiary. This leads to certain problems.

Who owns the goods?

Charities that sell donated goods through the trading subsidiary which then transfers the profits up to the charity need to consider how the goods became the property of the trading company. For example when goods are collected “house to house” charities must comply with the House to House Collections Act 1939. (This is an area that many charities often neglect believing that the rules governing house to house collections only apply to collections of cash and not collections of goods).

House to house collection licenses are granted in the name of the charity that means that goods are being collected by the charity and, in the eyes of the donor, for the charity. Similarly, when a donor donates goods at a shop surely their belief is that they are donating to the charity and not a separate non-charitable trading company. (Also see the rates issue point below.) The question is how are these donated goods “transferred” to the trading subsidiary to sell. There are, of course, complicated agency agreements that might allow this but then the profits of the sales must appear in the charity’s books and not in the trading subsidiary’s.

The principle being that charity should not gratuitously give goods donated to it to the subsidiary. I have heard the argument that the gift of the goods is given in exchange for the trading subsidiary covenanting or gift aiding back the profits. This is a dangerous argument, as it would invalidate the tax effectiveness of a deed of covenant payment. I have also heard the argument that the goods are being donated directly to the subsidiary but this causes other problems.

The rates issue

Section 43 of the Local Government Finance Act 1988 (LGFA) gives mandatory relief from non-domestic rates to charities where the rate payer is a charity or trustees for the charity and the property is wholly or mainly used for charitable purposes. This means that the channeling all the shop activities through a non-charitable trading company could fall foul of a proper interpretation of this relief. The rate payer being a trading company is not a charity and the property being used by the trading company is not used wholly or mainly for charitable

purposes. The fact that the trading company subsequently passes profits up to the charity does not in my opinion strictly allow it to obtain this relief. I have seen this point being taken by local authorities that are then denying rates relief.

Section 64 (10) of the LGFA extends the normal relief and explains that “A hereditament shall be treated as wholly or mainly used for charitable purposes at any time if at the time it is wholly or mainly used for the sale of goods donated to a charity and the proceeds of sale of the goods (after any deduction of expenses) are applied for the purposes of a charity.”

Some advisors believe that this allows the sale of donated goods to be taken through the subsidiary and that the shops should be run through the subsidiary but a relevant point in section 64 is that the goods must be donated to a charity – in which case the proceeds should be recognized by the charity.

The VAT issue

As explained, the law allows zero rating for goods sold by a trading company so long as they covenant all the profits of that supply to the charity. Interestingly, despite the specific reference to covenants in the legislation, in practice HMRC appear to accept that if a charity subsidiary transfers its profits by gift aid or dividend this will suffice.

However, I have seen them being fairly strict in the interpretation of the words “all the profits of that supply.” For example, consider a case where the trading subsidiary makes profits from the supply of donated goods of £100,000 and the trade of bought in goods has resulted in a loss of £10,000. In effect the trading subsidiary will have a composite profit of £90,000. In this case if it covenants the £90,000 to the charity it will not be covenanting “all the profits” of the supply of donated goods. I must confess that I have not seen this point taken but having discussed it with HMRC they do recognize the point and say that they would expect that all the profits of the subsidiary are passed to the charity to allow zero rating.

The Capital Gains Tax issue

If the shop property is owned by the trading company and is then sold at a gain the gain could be taxable. The exemption from capital gains tax conferred by S.256 of the Taxation of Chargeable Gains Act 1992 is available only to charities and not trading subsidiaries. Consequently, if there is a covenant in place it should be properly worded to allow the inclusion of capital gains.

The solutions

Clearly there are a number of problems associated with the structure of using the non-charitable trading subsidiary to sell all the goods. Consequently where the charity primarily sells donated goods I have always advocated that the shops should be owned by the charity and the “spare capacity” in the shops can be used to sell bought in goods for the trading company. This means that the charity must make an appropriate charge for overheads, rent and other costs including staff to the trading company.

Of course, direct costs of the purchase of new goods would be charged to the trading company in any case. Other costs can be apportioned in a fairly straightforward way. Many charities use a method based on turnover, for example if a shop sells 40% bought in goods and 60% donated goods then costs which are not directly attributed are simply divided on a 40/60

basis. HMRC have become tougher on the issue of cost allocation and the law now requires that costs are properly allocated.

For VAT purposes all input VAT relating to the shop should usually be recoverable since the shop will, in the main, be either selling zero rated goods via the charity and standard rated goods via the trading company. Thus even if the charity has to charge VAT to the trading subsidiary on the “management charge” the subsidiary should be able to recover it.

The law states that a property will pass the wholly or mainly used for charitable purposes test if it is wholly or mainly used for the sale of goods donated to a charity and the profits of sale are applied for the purpose of a charity. When a shop sells both donated and bought in goods I believe it qualifies so long as more than half the goods are goods donated to a charity for resale. I have seen some rating authorities take the view that “mainly” requires a much larger percentage but they have changed their mind when faced with the words of Lord Morton of Henryton. In *Facet Properties Ltd v/s Buckingham City Council* he acknowledged that the word “mainly” gave rise to difficulties but suggested that it probably did mean “more than half.” Clearly, the ratepayer must be a charity selling goods donated to the charity.

I usually recommend a structure where the charity owns the shops and is the ratepayer. This will also ensure that all donated goods collected in the charity’s name are sold by the charity and all bought in goods purchased by the trading company are sold on behalf of the trading company that is appropriately charged. Income and related expenditure on the sale of donated goods should directly flow through the charity’s accounts and turnover and costs associated with the bought in goods should go through the trading company which would transfer these profits the charity by gift aid or Deed of Covenant. This is the way that most of the large charity shop chains operate.

8. CONCLUSIONS

Guidance notes of this length can merely highlight some issues. There are several others such as consumer protection legislation, accounting, staffing, financial management, evaluation, rates relief etc. that must be considered.

Admittedly, the whole process does seem unnecessarily long winded and it appears that the charities do have to go through hoops and loops to ensure that income generation by trading is possible. But, the laws exist and ignorance is not bliss. Those charities that get it wrong could find themselves in very awkward and costly situations. It is perhaps useful to quote from the 1988 report of the Charity Commissioners:

Trustees have a duty to consider the tax effectiveness of the arrangements between them and any associated trading company, and they may be personally liable to account for taxation liabilities which are unnecessarily incurred directly or indirectly as a result of the inefficient administration of the charity. It makes no difference that the liabilities may arise not from the disqualification of the investment made by the charity, but from the disallowance to the associated trading company of corporation tax relief. The associated trading companies are not charities and are not directly subject to our jurisdiction, but we are of course concerned as to the manner in which charity trustees exercise the administrative rights which the ownership of the shares in those companies gives them.

In essence, when entering into activities that may appear to be trading it is important to consider:

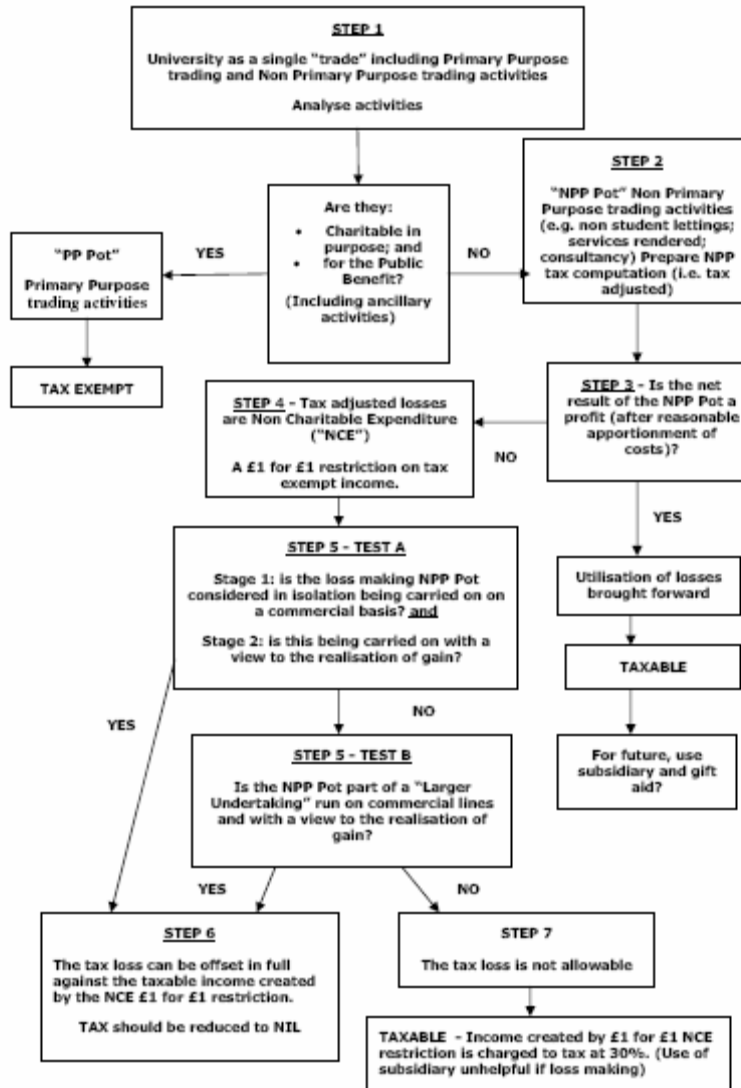
- What is the activity - is there any exchange of goods or services or is there any benefit to a third party?
- What are the charity law, direct tax and VAT implications?
- Does the charity's constitution allow it to carry out the activity?
- Should the transactions go through a trading subsidiary?
- Is the trading subsidiary properly set up and treated on an arm's length basis?
- Is the profit being properly passed over?
- Is the profit commensurate with the financial investment and effort?

There should also be proper procedures to enable the charity to transfer assets for use and exploitation by the trading company. In addition, the subsidiary's constitution should allow it to transfer profit to the charity.

Prior to establishing a trading subsidiary it is important to ascertain exactly what "trade" is to be carried out. There are many examples where trading subsidiaries have been established without considering whether it was necessary. Therefore, consider the rules - is it primary purpose trading?

It is also important to consider the question of financing and vital to remember that there needs to be a proper infrastructure to monitor and control the trading operation.

APPENDIX 1 – FLOW CHART REPRODUCED FROM HMRC’S GUIDANCE TO BUFDG



Article

Charity in Azerbaijan: Prospects for Developing Legislation and Practice

Mahammad Guluzade and Natalia Bourjaily¹

People of all walks of life are engaged in charity in Azerbaijan, businessmen and regular people alike. In spite of the existing traditions and the presence of political will to promote the development of philanthropy, however, there exist a number of serious legislative obstacles hindering charitable activities. Speaking of the issues related to charity in March 2008, Mrs. Mehriban Aliyeva, the First Lady of Azerbaijan, specifically emphasized “the lack of comprehensive legal and regulatory base governing charitable activities and the absence of an adequate mechanism providing for a partnership cooperation in the field of philanthropy between public agencies functioning on various levels of government, the private sector and civil society institutions.”²

In this article we attempted to provide an overview of the currently effective legislation and underscore certain pivotal issues which should be resolved. Although the Azerbaijani legislation declares support for philanthropy, it contains very limited incentives for charitable activities. A number of non-government organizations,³ including charitable ones, are funded by foreign grants, with a limited support provided by the local business community. The lack of interest in charity on the part of local businesses can be explained by a complete absence of tax benefits that would encourage such activities.

We hope that this article and the analysis carried out by the International Center for Not-for-Profit Law will help to improve the legislation regarding philanthropy and will assist in creating a national concept of developing charity in Azerbaijan.

History of formation of the charity-related legislation in Azerbaijan

In the very first years after the collapse of the Soviet Union, when Azerbaijan attained its independence, the state started paying attention to issues related to charity. The Decree by the President of the Republic of Azerbaijan “On the establishment of the President’s Fund” (1992) also set up a special award of the President’s Fund to be bestowed “for charitable activities and

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The original article is posted in Russian at <http://www.day.az/news/society/145183.html>

² See <http://www.day.az/news/society/112132.html>

³ Note that the Law “On non-government organizations (public associations and foundations)” (2000; hereinafter “the Law on NGOs”) and the Tax Code of the Republic of Azerbaijan (2000) (hereinafter “TC”) use different terminology. Consequently, the term “non-government organization” is used in the Law on NGOs while the TC refers to “non-commercial organization.” In actuality, both denote the same type of organizations. For the purposes of this article, we shall use the term “non-government organization” or “NGO.”

philanthropy.”⁴ The Law “On political parties” (1992) tried to separate charity from politics by imposing a ban on charitable organizations’ donations to political parties.⁵ The Law on entrepreneurial activities (1992) established the right of business entities to “make gratuitous contributions to public foundations, healthcare, charities, educational, research and civic purposes....”⁶ while the Decree of the Cabinet of Ministers of the Republic of Azerbaijan “On international humanitarian organizations and their affiliates in Azerbaijan” (1994) established regulatory provisions for the status of international humanitarian organizations engaged in charitable activities in Azerbaijan. The Resolution “On the social and economic situation in the Republic” passed by the Milli Majlis in 1994 even stipulated the development by the government of the draft law “On charity and sponsorship,”⁷ which, regrettably, has not materialized.

Article 38 of the Constitution of Azerbaijan (1995) establishes that the State shall provide for “the development of charity work, voluntary social insurance, and other forms of social security.”⁸ In part, the State has fulfilled this obligation by having included certain provisions regarding charitable activities into the Tax Code of Azerbaijan (2000).

While paying due respect to the existing legislative base pertaining to charity, we have to emphasize that many unresolved issues preclude the development of charitable activities. Below we shall address the ones that we deem most essential.

The currently effective legislation of Azerbaijan regarding charity

The main standards regulating charity are prescribed by the TC. The TC defines charitable activity as “activity performed by a natural person and/or charity organization, which consists of rendering direct assistance, to include the transfer of monies, without compensation, to physical persons in need of material or other assistance (aid), or to organizations and charitable organizations that directly provide such assistance (aid), including charity organizations, or scientific, educational or other activities performed in the public interest except where otherwise stipulated in this Code.”⁹

It is worth noting that rendering “direct assistance without compensation” to individuals in need or to charitable organizations by legal entities other than NGOs is not perceived as charity in accordance with the definition above. Nevertheless, such exclusion of legal entities does not entail any real legal consequences for said entities, because of the absence of any meaningful tax benefits as a result of charitable activities, or a legislative ban on both natural persons and legal entities engaging in charitable activities.

The legislation applies the notion of “sponsorship” to “other” legal entities, which de facto are engaged in philanthropy. Thus, for instance, “provision of non-commercial (charitable)

⁴ Decree of the President of the Republic of Azerbaijan “On the establishment of the President’s Fund,” Para 1.2, 1992.

⁵ The Law on political parties, 1992.

⁶ Art. 6 of the Law of Azerbaijan «On entrepreneurial activities,» 1992.

⁷ Resolution of the National Assembly of the Republic of Azerbaijan «On the social and economic situation in the Republic,» № 937, 1994.

⁸ Constitution of Azerbaijan, Art. 38.

⁹ Art. 13.2.35 of the Tax Code.

assistance to the development of sports” is defined as a type of sponsorship.¹⁰ The legislation fails to establish any real incentives for either sponsorship or charitable activities except for a few benefits for NGOs, which we shall address below.

Natural persons may be engaged in charitable activities and support individuals in need and philanthropic organizations but, just like legal entities, they are not eligible for any tax benefits which would provide incentives for their charity work.

The TC defines a charity organization as “non-commercial organization which conducts charitable activities.”¹¹ The legal framework in Azerbaijan does not provide for any separate legal regime and procedures/criteria that would single out a charitable organization from other NGOs.

There is a special procedure for registration of “international humanitarian organizations and other branches of foreign entities engaged in charitable activities.” In order for such an organization to commence its activities in Azerbaijan, it must obtain consent of the Cabinet of Ministers, which would provide grounds for the registration with the Ministry of Justice. Regular NGOs do not need such approval in order to register with the Ministry of Justice.

Tax benefits are believed to be the most ubiquitous and effective means of the government support of philanthropy. Regrettably, there are virtually no tax benefits that can be utilized in Azerbaijan at the moment. Taking into account the importance of tax preferences, we shall review the legislation of Azerbaijan governing the tax regime for a party implementing charitable activities in some detail. We shall focus on the situation of NGOs, including charitable organizations, and other legal entities and natural persons providing support to NGOs and individuals in need.

A number of NGOs, including charitable organizations, exist at the expense of foreign grants; consequently, they are exempt from several taxes, including taxation of their revenues acquired as part of a foreign grant, VAT, and social tax. Additionally, all NGOs are free from income tax on the revenues obtained from sources that are traditional for NGOs, such as gratuitous transfer of property, membership fees, and donations and grants from local sources. Revenues obtained from fundraising events, such as charitable balls or auctions, are treated as contributions and are free from income tax.

The Tax Code establishes that a charitable organization shall be free from taxation on all income¹² except for income acquired as a result of entrepreneurial activities. Nevertheless, as mentioned above, there does not exist a procedure or criteria that would differentiate a charitable organization from other NGOs. Proceeding from this, in practical terms, an exemption from income tax may only be utilized to the extent it is applicable to all NGOs.

Revenues from entrepreneurial activities of NGOs including those of charitable organizations are subject to income tax. As the Tax Code tends to define entrepreneurial

¹⁰ «On the fundamentals and rules of sponsorship in the sphere of physical culture and development of sports in Azerbaijan,» 2000.

¹¹ Art. 13.2.36 of the TC.

¹² Art. 106.1.1 of the TC.

activities in very broad terms,¹³ even a nominal entrance fee to a museum that is used to maintain the museum is subject to income tax.

Revenues from investments (for instance, gains on bank deposits) acquired by an NGO or other subjects of taxation are taxed at the rate of 10%¹⁴ at source, and no preferences are stipulated for NGO in regard of this source of income.

Neither legal entities nor natural persons are eligible for any privileges in regard to donations and grants they extend to charitable organizations or individuals in need.

The Tax Code also establishes a list of goods and services exempt from VAT irrespective of whether they are provided by non-profits or by commercial entities.¹⁵ Such goods and services exempt from VAT include procurement of goods, performance of jobs, and provision of services financed by the resources of foreign loans, foreign governments, and organizations pursuant to international agreements Azerbaijan is a party to. Also exempt are editing, publishing, and printing textbooks and literature for children and some other types of activities.¹⁶

Tax preferences aside, the legislation of Azerbaijan contains several non-tax incentives designed to encourage charity, including visa support and exempting foreign humanitarian organizations and their employees from the payment of state duties.¹⁷ Relevant Ministries and government agencies were mandated to provide assistance to foreign humanitarian organizations without any delays.¹⁸ Media outlets are mandated to provide 5% of broadcast time and advertisement space to advertising materials pursuing charitable purposes.¹⁹

Major issues regarding the charity-related legislation in Azerbaijan

Resolution of at least three major issues would allow for a considerable improvement of the legal environment and make it more conducive for the development of charity in Azerbaijan:

1. The procedure and criteria for distinguishing charitable organizations from other NGOs

The only difference between charitable organizations and other NGOs, as defined by the Tax Code, lies in the fact that the basis of activities of the former shall pursue public interests. In our experience, we have never encountered an NGO whose charter stipulates carrying out activities against public interests. Taking into account the fact that the legislation does not provide a definition of “public interests,” all NGOs at their own discretion may call themselves charitable ones: a club of beer friends, a paid aerobics club, a museum, or a homeless shelter. Within the framework of the existing legislation, all of them may qualify as charitable organizations. Meanwhile, in terms of public good, there certainly is a difference between a museum and a private membership-based club or an aerobics club where membership fees

¹³ Art. 13.2.37 of the TC.

¹⁴ Art. 123 of the TC.

¹⁵ Art. 164 of the TC.

¹⁶ Id.

¹⁷ Decree of the Cabinet of Ministers of Azerbaijan «On international humanitarian organizations and their affiliates in the Republic of Azerbaijan,» № 376, 1994.

¹⁸ Id.

¹⁹ Art. 19 of the Law of Azerbaijan «On advertisement,» 1997.

should actually be construed as payment for services. The State cannot afford to exempt all organizations from taxation. This said, there exists a widespread practice when the state grants wider benefits to certain organizations, usually defined as “public good” or “charitable,” than those enjoyed by other NGOs. A definition of activities implemented for the good of the public is important but not the only prerequisite for a precise and lucid differentiation of charitable organizations from other NGOs. The procedure and the criteria for establishing whether an organization qualifies as charitable are pivotal for enabling the State to consider the issue of granting special privileges to qualifying charitable organizations, avoiding abuse of privileges and decrease in taxes collected for the state.

2. Benefits for natural persons and legal entities making contributions and providing grants to charitable organizations

People tend to do good—for instance, give contributions to the poor—for purposes other than acquiring tax privileges. Although benefits in regard of income tax do not necessarily make people more generous, the findings of international research suggest that privileges do impact the volume of donations, which is especially true in the case of wealthier individuals and larger business entities. There is logic behind the fact that most countries established a benefit for natural persons and legal entities that envisages deduction of the sum of donation from the taxable profit. For instance, in the United States, an individual may deduct the value of his/her donation to a charitable organization in the amount of up to 50% of his/her annual net profit. In the event the sum of donations exceeds 50% of the annual net profit, such individual may get a tax credit for the sum not eligible for deduction this year and deduct it in the future fiscal years. It is not for nothing that philanthropy is widely spread in the US where there are numerous foundations with multimillion assets, which were endowed by rich philanthropists to support universities, schools, museums and theaters.

3. Partial tax exemption of revenues from entrepreneurial activities of charitable organizations allocated to pursuing constituent goals

Exemption of profits from entrepreneurial activities utilized for pursuing constituent goals of a charitable organization would provide for greater sustainability of this charitable organization, decrease its dependency on foreign financing, foster its ties with the population, and allow for a better concentration of efforts on the needs of the poor and a better quality of services provided to the population. In its turn, the acquired revenues would promote attaining the charitable goals of the organization. Fees for participation in a seminar may be allocated to carrying out free-of-charge workshops aimed at retraining the unemployed who do not have resources to pay tuition.

Conclusion

This article did not attempt to provide a detailed analysis of the legislation pertaining to charity in Azerbaijan. The format of this article does not allow for any comprehensive suggestions in regard to the elimination of the existing obstacles and improvement of the charity-related legislation. Unfortunately, there does not exist an unequivocal and simple solution to any of the aforementioned problems. All of these issues are difficult to resolve, and each country approaches them differently. Luckily, international practice has accumulated substantial experience in addressing these issues, and ICNL stands ready to share its expertise with all of the interested parties in Azerbaijan.

Review

Beyond the Rhetoric: Foundation Strategy
Kevin Bolduc, Ellie Buteau, Greg Laughlin,
Ron Ragin, and Judith A. Ross
Center for Effective Philanthropy

http://www.effectivephilanthropy.org/images/pdfs/CEP_Beyond_the_Rhetoric.pdf

“When a man knows he is to be hanged,” Samuel Johnson reportedly said, “it concentrates his mind wonderfully.” In the midst of this “Great Recession,” nothing seems to concentrate the minds of philanthropic and nonprofit leaders more than watching the rapid evaporation of endowment funds.

Beyond the Rhetoric: Foundation Strategy, a monograph from the Center for Effective Philanthropy, could not be making a more timely appearance. Ironically, the distinctive exemption from competitive and economic realities described by the researchers who wrote this report is now quite clearly a new collective vulnerability. In a field long noted for asking grant recipients to engage in certain types of accountability (collaboration, planning, and evaluation, among others), it could well be that foundations may emerge much stronger and healthier.

The researchers invited 50 CEOs from the largest 450 private foundations to participate in the study, and 21 accepted. Since a program officer from each foundation also was invited to participate in the study, the final study involved interviewing 42 individuals.

The basic finding is starkly simple and direct:

We learned that even though most of the CEOs and program officers interviewed believe that having and using a strategy increases a foundation’s ability to create impact, many do not use strategy in their own work. We asked respondents to describe the frameworks they use to guide their decisions. While some decision-making frameworks met our basic definition of strategy, a majority did not.

And what is that basic definition of strategy? According to the authors, strategy entails “a framework for decision-making that is (1) focused on the external context in which the foundation works and (2) includes a hypothesized causal connection between use of foundation resources and goal achievement.”

Four categories of philanthropic decision makers were identified by this research: Charitable Bankers, Perpetual Adjusters, Partial Strategists, and Total Strategists.

Charitable Bankers make their decisions strictly on the merits of a particular grant request without any apparent strategic concern. Their primary focus is on process: how grants are reviewed and awarded or declined. This category often applies to foundations that want to maintain maximum flexibility. This style is definitely reactive—responding to proposals rather than thinking about what kind of impact to make. Boards are quite involved in decisions, causing some level of consternation among staff.

Perpetual Adjusters also seem to be more interested in process than strategy, but foundations that “frequently add more programs, communities, grantee types and decision-

making frameworks to their work, yet rarely remove anything” also characterize this category. Stakeholder input is key, along with mission and values, but there is also a fair amount of “ongoing, internal disagreements about decision-making.”

Partial Strategists may use a strategy connected to some desired external goal from time to time, although any causal relationship between the foundation grants and public results is quite often coincidental. This approach typically relies on “mission, values, or broad beliefs when describing goals and resource use.” Other rationales for action include board interests, shifting external funding priorities, and CEO leadership.

Total Strategists organize all grantmaking activities with goal achievement uppermost in the minds of key decision-makers. This is the most proactive of the four types. Data and external analysis are quintessential elements of every funding decision. A written strategic plan is nearly universal among these funders. There is considerable interaction with key stakeholders and communities, although this interaction is more likely to focus on assessment rather than changing strategies.

The authors then examined how foundations compared when considering grantmaking (proactive, reactive, or responsive), assessment (primarily at the individual grant level) and boards (degrees of disagreement between board and staff).

Finally, there is the not necessarily surprising finding that the view from the CEO suite and the view from the program officer cubicle are different. Decades of studies in organizational behavior and management have yielded similar results in business, government, and nonprofit organizations. These findings simply remind us that decisions at the top require implementation throughout the organization if real change is to occur.

The monograph includes a sidebar profile on the Doris Duke Charitable Foundation’s “Wise Person Review” that helps foundation leaders get the “honest criticism” it considers a vital part of its strategy development and implementation. The monograph concludes with a case study highlighting the Gill Foundation’s record of strategic philanthropy.

The great strategist Yogi Berra once offered this helpful bit of advice: “When you come to a fork in the road, take it.” Since it is always advisable never to waste a good crisis, foundation leaders could make good use of these turbulent times with some constructive reflection on which strategic road they intend to follow.

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