House of Lords – Special Public Bill Committee on the Charities Bill – 2021

Response to CALL FOR EVIDENCE

Submitted by:
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and
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1. About myself

I have been involved in research on issues of charity law and regulation for more than 25 years, including holding the role of Professor of Charity Studies at Sheffield Hallam University from 2007-2015. I continue to practise as a professional adviser to a wide range of charities through The Kubernesis Partnership LLP. Much of my work is with small/medium charities. I specialise in the subtle differences in charity regulation between the three jurisdictions of the UK and on the interactions between the requirements of charity law and charity accounting.

I have a particular interest in Charitable Incorporated Organisations (CIOs) and am the author of a key book on the subject.[1] I have supported a wide range of charities being restructured as CIOs.

I have served on a number of panels and working parties with all three charity regulators in the UK (CCEW, OSCR, CCNI) and with the Irish Charities Regulator. On behalf of the four regulators of the UK and Ireland I acted as Independent Chair of the Charities SORP Governance Review in 2018/19.

I made a submission in 2015 to the Law Commission's *Consultation Paper No 220 Technical Issues In Charity Law* and a number of my comments are quoted in its 2017 Report. This year (2021) I have presented a detailed training event discussing the specific provisions in the Bill with smaller charities and advisers working with charities.

2. General comments

The vast majority of provisions in the Bill are very much to be welcomed for the reasons given by the Law Commission in its 2017 report and as expressed by the Government in HoL Second Reading Committee on 7 July 2021 (though I am concerned that it took four years for relatively uncontroversial recommendations to be brought forward as a Bill even though the Law Commission report provided a draft Bill).

For the most part the changes made by the Bill address a wide range of small but significant problems and limitations with provisions in the Charities Act 2011. **These changes will clearly be beneficial to the effectiveness of charities.** I comment briefly on each clause in section 3 below.

[1] Morgan, GG (2018) *Charitable Incorporated Organisations* (2nd edn) London: Directory of Social Change.

However, I have considerable concerns about the provisions in clause 3 which I believe will make it harder (rather than easier) for unincorporated charities to be re-established as CIOs – see my specific comments below on that clause.

I also have some minor concerns on the drafting of certain other clauses as set out below, and I am disappointed that the Government has not accepted a number of the Law Commission's recommendations, as explained on section 4 below.

3. Comments on specific clauses of the Bill

Clause 1 - Alteration of charitable company's purposes

I consider this change makes good sense. Whilst it perhaps imposes a slightly higher test than at present for a charitable company wishing to amend its objects, the revised wording in effect enshrines a clear *cy près* principle in such decisions.

Clause 2 – Amendments to constitution of CIOs

I warmly welcome these changes. The current system under which even purely administrative changes to a CIO's constitution do not take effect until registered by the Commission is a significant difficulty for CIOs wishing to update their constitutions.

I also welcome the alignment with charitable companies (clause 1) in the criteria to be applied by the Commission in considering regulated alterations to CIO constitutions.

Clause 3 – Powers of unincorporated charities

Whilst in general I welcome a more streamlined regime for amendments to the governing documents of unincorporated charities, I have real concerns about the removal of the process in sections 267-274 of the 2011 Act which allows an unincorporated charity to pass a resolution under s.268 to transfer all its property to a CIO *even if there is no explicit power in the charity's governing document*.

A real benefit of this process is that whilst the s.268 resolution has to be *notified* to the Commission under s.268(5) *it takes effect automatically after 60 days* under s.270 unless, within that time, the Commission objects or imposes further requirements under s.271.

Note that the financial limit in s.267(1)(a) does *not* apply if the transfer is to a CIO as a result of s.267(2) – so in principle this process can be used by any unincorporated charity wishing to be re-established as a CIO (except if is holds designated land – s.267(1)(b)).

I have used the process of a s.268 resolution with a range of unincorporated charities with older governing documents that have no clear dissolution clause (sometimes where the governing document is simply a schedule to a conveyance). The fact that the resolution takes effect *automatically* after 60 days (unless the Commission objects) is extremely important in ensuring that the transfer of assets to the CIO takes place on the timescale extended. For example, in the last year I used this process with two community centre charities that had no clear dissolution clause. They each passed a s.268 resolution in December 2020 or January 2021 and we gave notice to the Commission in late January. So, allowing 60 days to elapse, the resolutions took effect in late March 2021 enabling the community centre buildings and other assets to be transferred to the respective CIOs on 31 March 2021 to align with the end of the charities' financial years. In both cases the Commission responded in due course

confirming that it had no objection – but not until *well after the 60 day period.* If the trustees had been dependent on waiting for the Commission's explicit consent, these transfers could not have taken place until May 2021 which would have meant an awkward mid-year transfer of affairs to the CIO, or keeping the unincorporated charity in operation for a further 12 months. Transferring an unincorporated charity's affairs to a CIO is not just a matter of transferring assets: there are also considerations such as transfer of staff contracts, gift aid schemes, etc etc, which are enormously simpler if aligned with the financial year.[2]

So – whilst the new s.280A to be inserted in the 2011 Act by clause 3 is a broadly welcome simplification of complex arrangements in sections 267-280 – I consider it is <u>essential</u> that this is amended to retain the type of resolution currently provided by s.268, which takes place automatically after a certain time. I feel the current 60 day limit for objections from the Commission is reasonable both from the Commission's point of view and the charity concerned.

Without this, an unincorporated charity wishing to be re-established as a CIO whose governing document contains no effective dissolution clause would have to undergo a complex three stage process:

(a) It would first have to amend its governing document to add such a dissolution provision – in practice under the process in s.280A(2)-(6). This would generally require preparation of a complete new trust deed or equivalent if the existing governing document was part of a will or conveyance which would generally incur significant costs.
(b) This amendment would require the Commission's explicit consent under s.280A(7) – with no specific time limit for the Commission to respond.
(c) Under the amended governing document, the trustees (and members if applicable) would pass a resolution to transfer all property to the CIO. Once the transfer was made the amended trust deed adopted at stage (a) would then be redundant!

In practice, the additional complexity of this process including the preparation of a new trust deed at stage (a) would, I suggest typically increase the professional fees for such an unincorporated charity wishing to be re-established as a CIO by at least £1000 and would probably require an additional six months to complete all the stages. It seems wholly wrong to force a small unincorporated charity with a dated constitution to go through the process of completely revising its governing document when the new governing document will only be in force for an extremely short period until the CIO takes over.

It is already a relatively complex process for an unincorporated charity to be re-established as CIO, especially during the period when the old charity and the CIO both exist in parallel and removal of the s.268 resolution arrangements will make this much worse.

I would therefore recommend <u>retaining</u> the provision in section 267-274 allowing a resolution to transfer property directly from an unincorporated charity to a CIO with similar objects. But the process could be greatly simplified and redrafted as a single section along similar lines to the proposed s.280A. (These provisions could also be simplified further by removing the exclusion in s.267(1)(b) for charities with designated land.)

[2] See Morgan *CIOs* chapter 9 for detailed discussion of the steps involved when an unincorporated charity is to be established as a CIO, including the use of s.268 resolutions where applicable.

Clause 4 – Power to amend Royal charter

The proposals appear sensible, but I have no specific experience with Royal charter charities.

Clause 5 – Orders under section 73

The proposals appear sensible, but I have no specific experience of this.

Clause 6 – Cy près powers

I welcome the changes made by this clause which will greatly clarify the *cy près* framework.

However, I do wonder if it would be possible to dispense with the confusing term "*cy près*" and express the principles in modern English?

Clause 7 – Proceeds of fund-raising: power of charity trustees to apply cy-près

I very much welcome the changes made by this clause which will certainly simplify the procedures and give clarity to trustees where funds have been raised that cannot be spent .

However, as explained above in relation to clause 3, I would prefer to avoid the need for explicit Charity Commission consent – rather a resolution under the new s.67A(2) should take effect automatically 60 days after notification to the Charity Commission *unless* the Commission objects or wishes to raise queries. If that change is made, I feel the limit of £1,000 in s.67A(4) is reasonable (but if not, the limit should be higher).

My comment above (clause 6) on replacing the term *cy près* is also very relevant here, especially as simple resolutions of the kind envisaged by this section will often be passed without the involvement of professional advisers.

Clause 8 - Power of the court and the Commission to make schemes

This provision makes eminent sense.

Clause 9 – Definition of "permanent endowment"

Although I welcome clarification of the definition of "permanent endowment" I am not sure about the specific alternative definition proposed – I suggest this needs further consideration. On balance I would prefer to keep the existing definition in s.353(3) of the 2011 Act.

I can see several problems with the new definition proposed by this clause:

(a) Whilst I note the need to distinguish income and capital, it is only the capital that would be classed as permanent endowment, but the new definition seems to suggest that both the capital and the income from an endowment would also be regarded as permanent endowment – which is nonsense.
(b) The definition need to exclude expendable endowments (where property is given to a charity on the basis that the capital is normally to be retained but can be spent at the trustees' discretion) but this isn't made clear.
(c) Some forms of permanent endowment – particularly land – may generate no income, but it seems that endowments of this kind could be excluded from the new definition.

Clause 10 - Amendment of powers to release restrictions on spending capital

The clarifications and simplified processes introduced by this clause are helpful.

Clause 11 – Taking effect of resolution under section 282 of the Charities Act 2011

I welcome the improvements made by this clause regarding the period of time for resolutions to take effect. In particular, I welcome the principle of resolutions taking effect automatically 60 days after notification to the Charity Commission unless the Commission objects. This aligns with my comments on clause 3.

Clause 12 – Power to borrow from permanent endowment

The changes made by this clause are for the most part very welcome and will provide useful flexibility to the charities concerned (although charities with permanent endowment are only a small proportion of the sector and many of these have permanent endowment in the form of land – the clause seems to be drafted primarily for those holding permanent endowment in the form of investments).

However, I have a few comments on points of detail. In particular, the definition of "available endowment fund" in the new s.284A(9) obviously depends on the new definition of "permanent endowment" – see my comments on clause 9. I would also suggest clarification of the wording in the proposed s.284A(2) to include permanent endowment held as land, where any borrowing would generally require mortgaging the land. If this is to be allowed in the circumstances allowed by this section I suggest the wording should make that clear. If so, I suggest the wording also needs to make clear in such cases whether the provisions in s.124 on mortgaging of charity property would *also* need to be followed.

Clause 13 – Total return investment

The proposals appear sensible, but I have no specific experience of this.

Clause 14 – Special trusts

The changes and simplifications made by this clause are very welcome. However, few charities nowadays use the term "special trust" – the normal term is "restricted fund" (as used extensively in the Charities SORP[3]). So, if the definition is being changed, I suggest it would be clearer to use the term "restricted fund" throughout the Act in place of "special trust".

Clause 15 – Small ex gratia payments

This is very welcome and will be very helpful to charities of all sizes. I consider the thresholds proposed in the new s.331A(6) are completely appropriate.

Clause 16 – Power of Commission etc to authorise ex gratia payments etc

This provision makes eminent sense.

[3] Accounting and Reporting by Charities: Statement of Recommended Practice – see www.charitysorp.org.

Clauses 17 to 24 – Charity Land: Disposition and mortgages

I warmly welcome the clarifications and updated procedures introduced by these clauses.

Clauses 25 to 28 – Working names and unsuitable names

These provisions make eminent sense. I have advised some charities which have had difficulties with other charities using inappropriate names or working names and it is essential to give the Commission power to act in such cases.

Clause 29 – Powers relating to appointments of trustees

This provision makes eminent sense.

Clause 30 – Remuneration of charity trustees etc providing goods or services to charity

This provision is much needed. It will allow almost a page of technical provisions along these lines to be removed from the Commission's model constitutions. It will be especially helpful for the vast numbers of small/medium charities now being established as CIOs.

However, the Commission needs to establish a simplified procedure to allow charities which have such provisions in their existing constitutions to remove the unnecessary wording without needing full consent for a regulated alteration.

Clause 31 - Remuneration etc of charity trustees etc

Whilst I hope the Commission will provide much more education about the need to ensure proper prior consent under s.185 in cases where remuneration is to be paid to a trustee or connected party, I agree the Commission needs the power given by the new s.186A in exceptional cases.

Clause 32 – Trustee of charitable trust: status as trust corporation

This provision makes eminent sense.

Clause 33 – Charity mergers and vesting declarations

These changes are extremely welcome. I have made frequent use of the Charity Mergers Register on behalf of clients, but the current exclusion of conditional gifts is always a slight worry.

I am particularly encouraged that sections 239 and 244 of the 2011 Act regarding CIO to CIO mergers are being amended along with section 311 which deals with the Charity Mergers Register itself.

Clauses 34 to 35 – Vesting declarations

This clause is very hard to follow, not least because s.310 of the 2011 Act is already amended by reg.61 of the CIO General Regulations 2012 in the case of a vesting declaration in favour of a CIO. The "Keeling Schedule" that has been helpfully published alongside the Bill showing the 2011 Act as amended by the Bill does not seem to allow for this.

The Bill would be much clearer if it deleted s.310 in its entirety (and also repealed reg.61 of the 2012 CIO Regulations) and replaced it with a complete new section including specific provisions for CIOs.

I would also ask that the revised s.310 should include the subsection (5) inserted by reg.61 making clear that the specified trust property and the transferee are to be treated as a single charity (unless the Commission directs otherwise). This currently seems to be missing.

However, I welcome the clarification to s.306 made by clause 35.

Clause 36 – Costs incurred in relation to Tribunal proceedings etc

This provision makes eminent sense.

Clause 37 – Public notice of Commission consent

This provision makes eminent sense.

Clause 38 to 39 – Connected persons

These provisions makes eminent sense.

Clause 40 – Minor and consequential provisions

I am generally content with the changes made by Schedule 2, though I suggest some of them – or perhaps the omissions from this Schedule – are more than "minor and consequential".

The small changes to Schedule 6 of the 2011 Act (paras 2 and 8 of the Schedule 2 of the Bill) are reasonable, but I would have wished to see much more extensive changes to Schedule 6 of the 2011 Act allowing any formal decision or order of the Charity Commission to be appealed to the Tribunal (see further below).

It also seems absurd that a number of terms are defined more than once in the 2011 Act with slightly different definitions in each case and these are not generally resolved by the present Bill. The most serious issue relates to the definitions of "Connected persons" which appears (with slightly different wording) in sections 118, 188, 200 with a clarification in section 350. I suggest giving a single full definition of the term in s.350 and other sections of the Act should cross-refer to this (with the same definition to apply in each case).

Clause 41 – Extent, commencement and short title

I am uncomfortable with clause 41(4). This Bill is largely making technical and clarificatory changes, or is creating new permissions rather than imposing new requirements. Yet the vast majority of its provisions only take effect when commencement orders are laid. I am concerned that many of the important provisions in the Bill could end up being excessively delayed: there are still significant provisions in the 2011 Act itself that are yet to be implemented. I suggest that clause 41(4) should *only* apply where the Charity Commission needs to institute significantly changed procedures, and other changes should take effect immediately on Royal Assent.

4. Issues recommended by the Law Commission but not included in the Bill

I do not have any comment on the recommendations where Privy Council involvement applies, but I would comment as follows on the remaining Law Commission recommendations that were not fully accepted by the Government.

Recommendation 16 – I agree that disposals of land by charities to their subsidiaries should continue to be regulated under the Act. I agree with the comments in the Government response that "charities frequently fail to appreciate the need to deal with subsidiaries on an arm's length basis and do not appropriately manage conflicts of interest". So I feel the Bill is appropriately drafted on this issue.

Recommendation 18 – I agree that disposals of designated land should in general continue to be advertised under the process in section 121 of the 2011 Act. However, the drafting of that section does not take into account the common situation where the designated land is not being sold but simply transferred as by way of a gift as part of a merger with another charity (typically a CIO) with almost identical objects. It would be helpful if the requirements of s.121 could be omitted where the land is being transferred to another charity with similar objects under the provisions of a s.310 pre-merger vesting declaration.

Recommendation 27 – As I comment above in relation to clause 40, I am concerned that the Government dismissed this recommendation. It should be possible to appeal to the Tribunal on any formal decision made by the Commission in relation to a specific charity or its trustees.

Recommendation 40 – I am concerned that the Government did not accept the case for an independent process for authorising charity proceedings where the Charity Commission has a conflict of interest as in the *Beddoe* order applications mentioned in the Law Commission report (p.338). Across the sector such cases are relatively rare and of course charitable assets need to be protected, but asking the Charity Commission to take the decision in such cases is tantamount to requiring someone accused a criminal offence to seek police approval before appointing a defence lawyer on the grounds that the costs of the defence might diminish the assets recoverable if the person is convicted.

Recommendation 43 – I do not understand why the Government rejected the recommendation that the Charity Commission should be able to make a reference to the Tribunal without requiring prior consent from the Attorney General. The Charity Commission has clear statutory objects, functions and duties in section 14-16 of the 2011 Act and any reference would surely only be made if the Commission's Board was satisfied that a Tribunal decision on the matter referred to it would enable the Commission to reach decisions more effectively.

5. Summary

I trust these comments are of help to the Committee – I will be pleased to elaborate on any issue.

Gareth Morgan
September 2021