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LIBRARY NOTE

Charities Bill [HL]

[HL Bill 15, 2004-05]

LLN 2005/001

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1. Introduction

The Charities Bill [HL] was introduced in the House of Lords on 20th December 2004. It is due to have its second reading on 20th January 2005.

Announcing the Bill's publication, a Home Office press release stated:

The vital importance of the charity and community sector was highlighted by the Government today as it published the Charities Bill, following its inclusion in the Queen's Speech on 23 November 2004.

The Bill will support the work of thousands of people and organisations across the country to make a real impact on their community, through a variety of measures designed to improve the ways in which charities are run and regulated. Recognising the ways in which charitable organisations can contribute to the development and delivery of public services, the Charities Bill will provide a modern, sustainable framework through which charities can fulfil their aims. It contains a range of measures designed to enable charities to administer themselves more efficiently and to be more effective in their work.

The Bill establishes public benefit as the bedrock of charitable status, provides for the modernisation of fundraising regulations and sets out reforms to the Charity Commission to help it in its role as regulator.

The voluntary and community sector is uniquely placed to become a more active partner with Government in shaping policy and delivery. The move towards the new Bill began in the mid-1990s with work initiated by the National Council for Voluntary Organisations. It implements the recommendations of the Prime Minister's Strategy Unit, following a comprehensive and detailed review of the legal and regulatory framework of charities and other organisations involved in the sector.

Charities Minister Fiona Mactaggart said:

“Charities can make a real difference to countless people's lives. Thousands of people benefit from charitable action. Many others donate money, volunteer their time and talents or work as a trustee. Charities are held in high regard.

“The Charities Bill builds on this foundation of confidence in the work of the sector, reforming charity law and regulation with an emphasis on public benefit and the significant regulatory role of the Charity Commission.

“The Government is working with charities and voluntary organisations to promote strong, active and involved communities which are capable of taking responsible action on issues directly affecting them. Many voluntary organisations enjoy strong partnerships with Government in achieving their aims, but the continued independence of the sector is something to be maintained and cherished.”

The Bill is divided as follows:

- 1) Part one contains definitions of “charity” and “charitable purpose”.
- 2) Part two is made up of eleven chapters and deals with the regulation of charities. It establishes the Charity Commission for England and Wales as a body corporate; it establishes the Charity Appeal Tribunal to hear appeals from decisions of the Charity Commission; and it deals with various regulatory matters.
- 3) Part three makes provision in relation to funding for charitable, benevolent or philanthropic institutions.
- 4) Part four makes general provisions.

The Bill emerges partly from the increasingly complementary roles that Government and the voluntary sector play in the development and delivery of public services but, crucially, charities will continue to choose for themselves how closely they engage with Government, maintaining the independence cherished by both the Government and the sector.

(Home Office, ‘Charities Bill will back voluntary and community sector’s work to change lives’, 21st December 2004)

A press release issued by the Charity Commission for England and Wales, the regulator and registrar for charities, whose structure and remit would be altered by the Bill, welcomed the provisions:

The Charities Bill was announced in the Queen’s Speech last month and includes a number of provisions. It paves the way to greater empowerment of the charitable sector and a defined role for the Charity Commission to both ensure compliance and engender accountability. Its publication is a further step in the process of it becoming law. The Bill :-

- * will provide greater freedom for charities to operate within a more flexible legal framework which will help them respond to changes in society
- * supports trusteeship by providing simpler arrangements for obtaining relief from liability for honest mistakes, and paying trustees for providing services
- * supports greater choice by establishing a new structure for charities - the Charitable Incorporated Organisation which will simplify administration and reduce risk for charities which want to be companies
- * provides new descriptions for charitable purposes
- * places benefit to the public at the heart of charitable action

The Bill also includes, for the first time, a new role for the Charity Commission as part of a modernised regime to regulate anyone collecting funds in public places for good causes.

Geraldine Peacock, Chairman of the Charity Commission, said,

“Today is a landmark for charities and for the Commission. The publication of the Bill is a true testament to the work and commitment put in by so many in the sector to ensure it becomes a reality.

We warmly welcome the Government’s statement that the Commission’s independence is of paramount importance for the proper regulation of charities and for public confidence in charities.

We welcome the increased flexibility for charities to evolve and grow. Charitable endeavour is at the heart of modern society. The Bill provides a legal structure and support framework to enable charities to feel the pulse of the communities they serve and help individuals to achieve their aspirations.

I am also delighted that the Bill will provide a modern framework for us to work in partnership across traditional boundaries to increase effectiveness and grow public trust and confidence. Our new role in registering public collections will help this even further.

This is the beginning of a new era for charitable action, one which releases potential and increases effectiveness.”

Andrew Hind, Chief Executive of the Commission added,

“The Bill gives a number of additional responsibilities and tasks to the Commission, which we welcome. I believe we have a vital role to play in assisting charitable endeavour in society. However, it will be essential for the Commission to be adequately funded in order to effectively carry out this important additional work.”

(Charity Commission, ‘New role for Charity Commission as it welcomes Bill’s publication, 21st December 2004)

Except for a small number of amendments to other statutes, and for two substantive provisions, the Bill extends to England and Wales only. Charity law and regulation are now devolved matters in both Scotland and Northern Ireland; before devolution, however, each of those territories had its own body of charity law different from the law applying in England and Wales. An equivalent Bill, the Charities and Trustee Investment (Scotland) Bill, is currently being taken forward by the Scottish Executive.

The financial effects of the Bill are summarised in paragraphs 232-4 of the Explanatory Notes, and a final regulatory impact assessment has been published alongside the Bill.

The purpose of this Library Note is to provide some background to the evolution of the Bill and to give a concise overview of its provisions, before looking in more detail at one part of the Bill that has proved controversial – the proposed statutory definition

of charity and charitable purposes. It also summarises debate on one proposal that has not been included in the Bill – that charities be allowed to trade directly.

2. Background

2.1 *Private Action, Public Benefit*

In July 2001, the Prime Minister commissioned the Strategy Unit to undertake a review of the law and regulation of charities and other not-for-profit organisations. The Strategy Unit published its review, *Private Action, Public Benefit*, in September 2002. The review made a number of recommendations intended to: modernise charity law and status; improve the range of legal forms available for charities; develop greater accountability and transparency; and ensure independent, fair and proportionate regulation. Its recommendations included:

- updating and expanding the list of charitable purposes
- requiring a clearer focus on public benefit
- allowing charities to trade directly
- enabling charities to campaign
- reducing bureaucracy that inhibits charities from modernising their constitutions, merging with others, or using their endowments in different ways
- improving the range of legal forms available to charities and social enterprises
- developing greater accountability and transparency by improving information available to the public and regulating fundraising more effectively
- updating the rules on registration with the Charity Commission
- modernising the Charity Commission's role as the regulator for charities
- creating an independent tribunal to enable trustees to challenge Charity Commission decisions at reasonable cost

Following consultation, the Government published its response to *Private Action, Public Benefit* in July 2003 (*Charities and Not-For-Profits: A Modern Legal Framework*). The Government agreed to accept all but one of the main recommendations, with some modifications, and confirmed its intention to publish a draft Charities Bill. The Government decided not to accept the Strategy Unit's recommendation to allow charities to trade directly, without the need for a trading company. While there had been some support for this recommendation from a number of respondents to the consultation, the Government argued that 'conducting trading activities within the tax exempt structure of charities would offend the principle of a level playing field with private sector businesses' (paragraph 3.34).

The Government accepted the Strategy Unit's recommendation for a new unified local authority licensing scheme for public collections, and undertook to consult on the detailed working of the scheme, following difficulties encountered in implementing a similar scheme under the Charities Act 1992. A consultation paper on this proposal, *Public Collections for Charitable, Philanthropic and Benevolent Purposes*, was published in September 2003, and a summary of responses was issued in May 2004.

Not all of the Strategy Unit's recommendations required legislative action, and others have already been taken forward separately. Proposals for Community Interest Companies, for example, received Parliamentary approval with the passage of the Companies (Audit, Investigations and Community Enterprise) Act 2004, sponsored by the Department of Trade and Industry.

2.2. The draft Bill and report of the Joint Committee

In May 2004 the Government published the draft Charities Bill for pre-legislative scrutiny, accompanied by explanatory notes and a draft regulatory impact assessment (Cm 6199). A Joint Committee of both Houses of Parliament was appointed on 10th May 2004 to examine the draft Bill and to report to both Houses by the end of September 2004. The Joint Committee held eight oral evidence sessions within the time available, and received over 350 written submissions. Its report, together with the oral and written evidence, was published on 30th September 2004 (HL Paper 167/HC 660, 2003-04). In a press release accompanying its report, the Joint Committee expressed support for the proposed reform and modernisation of charity law, which it believed was 'long overdue':

[The Joint Committee] is particularly keen to ensure that smaller charities are not over-burdened by regulation, and would like to see charities given greater freedom to trade. Further key recommendations concern the role and remit of the Charity Commission and the Charity Appeal Tribunal, the accountability of professional fundraisers, the definition of public benefit and the clarification of charitable purposes, especially those relating to religion and the promotion of religious and racial harmony.

The Committee recognises the huge diversity of the sector and has been particularly concerned to hear from the many smaller voluntary-run local charities during the course of its inquiry. George Foulkes MP, acting chairman, said:

“We strongly believe that charitable endeavour continues to be the cornerstone of a caring society comprised of active citizens. Charities are valued as organisations independent of Government. We would like to see charities playing an even bigger role and believe that many have the potential to contribute to the modernisation of public services and the enhancement of civic responsibility. Our assessment of the Bill and the recommendations we make are based on a desire to see charities – and charitable endeavour and income – grow, not diminish, in our country.”

(Joint Committee on the draft Charities Bill, 'MPs and Peers welcome modernisation of charity law', 30th September 2004)

3. The Bill

Following its announcement in the Queen's Speech of 23rd November 2004, the Charities Bill [HL] was introduced in the House of Lords and given its first reading on 20th December 2004. At the same time, the Government published a response to the report of the Joint Committee that had scrutinised the draft Bill (Cm 6440). This presented the Government's responses in turn to each of the Joint Committee's recommendations. In a number of areas, the Government accepted the findings of the Joint Committee, and had amended the Bill accordingly.

The Bill's Explanatory Notes provide the following summary of its clauses:

The Bill has 72 clauses and nine Schedules and is divided into four Parts.

Part 1 (clauses 1-5) deals with the definition of a charity and of charitable purposes.

Part 2 (clauses 6-41) deals with the regulation of charities and is divided into 11 Chapters as follows:

Chapter 1 (clauses 6 and 7 and Schedules 1 and 2) covers the objectives, functions and constitution of the Charity Commission;

Chapter 2 (clause 8 and Schedules 3 and 4) covers the creation of a tribunal to hear appeals against some types of decision made by the Charity Commission;

Chapter 3 (clauses 9-14 and Schedule 5) covers the registration of charities, including new arrangements for the registration of larger exempt charities and for the regulation of exempt charities. (Exempt charities are charities not at present obliged to register with the Charity Commission, though they are regulated by it. Exempt charities are charities at present neither registered with nor regulated by the Commission);

Chapter 4 (clauses 15-18) covers changes to the rules governing the application, by scheme, of charity property "cy-près". Charity property is said to be applied "cy-près" when it is used for purposes different from, but close to, the purposes for which it was originally given;

Chapter 5 (clauses 19-26) covers the assistance and supervision of charities by the court and the Charity Commission. It includes new powers for the Commission:

(clause 19) to suspend or remove trustees, employees etc from membership of their charity;

(clause 20) to direct charity trustees to take certain actions in administering their charity;

(clause 21) to direct charity trustees to apply the charity's property in a certain way;

(clause 24) to give advice and guidance to charity trustees;

(clause 25) to determine who are the members of a charity; and

(clause 26) in the course of statutory investigations, to enter premises and take possession of information and documents.

Chapter 5 also includes a provision (clause 22) relaxing the rules on the advertising of schemes and a provision (clause 23) to allow Common Investment Funds and Common Deposit Funds to accept investments from Scottish and Northern Irish charities.

Chapter 6 (clauses 27 and 28) covers the audit and examination of the accounts of unincorporated charities and the duties of auditors and examiners of those charities;

Chapter 7 (clauses 29-31) affects charitable companies only, covering changes to the rule restricting amendments to their constitutions, and the audit and examination of their accounts;

Chapter 8 (clause 32 and Schedule 6) provides for the Charitable Incorporated Organisation, a new legal form for charities;

Chapter 9 (clauses 33-36) covers changes to the rules on the disqualification of persons from acting as trustees, the remuneration of charity trustees, and the relief of trustees from personal liability for breach of trust or duty;

Chapter 10 (clauses 37-39) covers changes to the rules under which small unincorporated charities may transfer their property to other charities, replace their current charitable purposes with new ones, or modify their constitutional powers or procedures;

Chapter 11 (clauses 40 and 41) covers the spending of capital endowment funds by charities, and the registration of mergers between charities.

Part 3 (clauses 42-67) deals with fundraising by, and the funding of, charities and other benevolent or philanthropic organisations and is divided into three Chapters as follows:

Chapter 1 (clauses 42-63) establishes the arrangements for the conduct and regulation of public charitable collections;

Chapter 2 (clauses 64 and 65) makes changes to the rules requiring statements to be made to donors and consumers by, respectively, professional fundraisers and commercial participators. It also gives the Secretary of State a reserve power to regulate most forms of fundraising by charities and other benevolent and philanthropic organisations.

Chapter 3 (clauses 66 and 67) contains new powers for the Secretary of State, and for the Welsh Assembly, to give financial assistance to charities and other benevolent and philanthropic organisations.

Part 4 (clauses 68-72) contains the final provisions, covering:

(clause 68) the rules applying to the Secretary of State when he makes an order or regulations under the Bill

(clause 69 and Schedules 7-9) amendments to, and repeals of, other Acts of Parliament, and transitional provisions and savings;

(clause 70) interpretation of words and phrases;

(clause 71) short title, commencement and extent.

(HL Bill 15–EN, paragraphs 3-7)

The following sections of the Library Note cover the Joint Committee’s scrutiny of the draft Bill, and the Government’s response to the Joint Committee’s recommendations, in relation to two areas of particular controversy: the proposed statutory definition of charity and charitable purposes under Part 1 of the Bill, and the Strategy Unit’s recommendation, not included in the Bill, that charities be allowed greater freedom to trade.

3.1 Meaning of ‘charity’ and ‘charitable purposes’

Part 1 of the Bill as introduced in the House of Lords provides a new general statutory definition of ‘charity’ for the purposes of the law. Clause 1 specifies that a body or trust is a charity if established for ‘charitable purposes’ only (maintaining the existing position whereby a body or trust which has non-charitable as well as charitable purposes is not a charity) and is subject to the jurisdiction of the High Court. Clause 2 sets out a definition of ‘charitable purposes’. Clause 2(1) provides that a purpose is charitable if it meets two criteria:

- that it falls within one or more of the descriptions under clause 2(2); and
- that it is for the public benefit.

This would replace in statute the existing common law definition of charitable purposes. Under existing law, for a purpose to be charitable it must fall under one of four ‘heads’ – the relief of poverty, the advancement of education, the advancement

of religion, or other purposes beneficial to the community. It must also be for the public benefit. Purposes under the first three ‘heads’, relating to poverty, education and religion, have been presumed to be for the public benefit, while purposes under the fourth ‘head’ have required proof that they are for the public benefit.

The existing definition has developed entirely through case law, although it derives originally from the Charitable Uses Act 1601, sometimes referred to in charity law as the Statute of Elizabeth I, the preamble to which contained a list of purposes then considered charitable. Lord Macnaghten, in *Income Tax Special Purpose Commissioners v. Pemsel* [1891] AC 531, grouped charitable purposes into the four ‘heads’ mentioned above.

The following sub-sections look at the two conditions that must be satisfied under the Bill for purposes to be considered charitable, and the consequences should an organisation lose its charitable status.

3.2 List of charitable purposes

Clause 2(2) provides a list of charitable purposes, expanding the current list of four purposes under the common law:

- (a) the prevention or relief of poverty;
- (b) the advancement of education;
- (c) the advancement of religion;
- (d) the advancement of health or the saving of lives;
- (e) the advancement of citizenship or community development;
- (f) the advancement of the arts, culture, heritage of science;
- (g) the advancement of amateur sport;
- (h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- (i) the advancement of environmental protection or improvement;
- (j) the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- (k) the advancement of animal welfare;
- (l) other purposes – specifically, those already recognised under existing law, and those analogous to, or in the spirit of, purposes listed above or already recognised (as defined in clause 2(4)).

Discussing the corresponding clause in the draft Bill, the Joint Committee noted that the majority of respondents favoured an expanded list of charitable purposes being set out in statute, although several suggested that the list be further extended or amended. Accordingly, the Joint Committee recommended a number of changes (HL Paper 167/HC 660, 2003-04, paragraphs 48-60). Several of these were accepted by the Government, such as the addition of ‘the saving of lives’ to the purpose of the advancement of health; and the addition of ‘culture’ to the purpose of the advancement of arts, heritage and science, with the effect of bringing the Bill into line with the equivalent Bill in Scotland. The Government was not persuaded, however, to accept the Joint Committee’s recommendation that the Bill include a definition of

‘religion’ in order to clarify that multi-deity or non-deity groups would be included. The Government believed that the existing common law definition would be sufficient for religious groups to qualify for charitable status (Cm 6440, paragraphs 3-7).

3.3 Public benefit

Clause 3 sets out the ‘public benefit’ test, the second condition that must be satisfied if a purpose is to be considered charitable. Clause 3(2) removes the presumption that organisations for the relief of poverty, the advancement of education, or the advancement of religion are for the public benefit. Thus, a clear change effected by the Bill is that charities of all purposes will be required to demonstrate they are for the public benefit. Public benefit is not defined on the face of the Bill. Rather, clause 3(3) provides that ‘public benefit’ refers to the existing concept in charity law in England and Wales, and thus will remain a matter of common law. This reflects the recommendation of the Strategy Unit, agreed by the Government, that all charities ought to demonstrate public benefit, but that a statutory definition of public benefit would be disadvantageous. Clause 4 requires the Charity Commission to issue guidance as to the operation of the public benefit test.

The public benefit provisions proved controversial during pre-legislative scrutiny, principally because of the anticipated difficulty as to how schools and hospitals that charge high fees, but which also currently enjoy charitable status, will be able to demonstrate public benefit when access to their services is limited to those who can afford to pay. Commenting on the provisions contained in the draft Bill, the Joint Committee summarised the issue as follows:

The draft Bill does not explicitly purport to change the charitable status of such organisations. This is not necessarily the most important issue facing the charity sector but it does appear to be an area of great uncertainty about how the draft legislation will work in practice. It has also been the subject of much controversy over many years with some arguing strongly that the fact that wealthy independent schools enjoy charitable status – and the tax advantages it confers – is incompatible with any common sense view of what it means to be a charity. Since the purpose of the Bill, according to the Minister, is to protect the charity brand, it is important that any new law on charity must properly deal with the issue of public benefit.

(HL Paper 167/HC 660, 2003-04, paragraph 64)

The Joint Committee found support from the voluntary sector for this change, with, for instance, the National Council for Voluntary Organisations agreeing that all charitable organisations should be required to demonstrate public benefit on an ongoing basis. On the question of whether fee-charging schools or hospitals do in fact provide public benefit, the evidence was divided (*ibid*, paragraphs 84-93). However, the Joint Committee noted that there were conflicting opinions on the question of how much difference the draft provisions would make in practice. The Charity Commission, the body that would implement the new law, suggested that the

removal of the presumption of public benefit would probably not affect those organisations, like independent schools, that until now had not been required to demonstrate public benefit. The Government, however, indicated that the provisions as drafted ensured that all charities in future would have to demonstrate public benefit. On the apparent disagreement between the Charity Commission and the Government, the Joint Committee reported:

This is deeply unsatisfactory. For a matter of such public importance and interest to produce such total confusion at the heart of the draft Bill is nothing short of farcical.

(*ibid*, paragraph 76)

Consequently, the Home Office and the Charity Commission agreed a joint position (or ‘concordat’), which was reproduced in the Joint Committee’s report, on the Charity Commission’s approach to assessing public benefit, and outlining the broad principles that would apply specifically to fee-charging organisations:

- a) both direct and indirect benefits to the public or a sufficient section of the public may be taken into account in deciding whether an organisation does, or can, operate for the public benefit;
- b) the fact that charitable facilities or services will be charged for and will be provided mainly to people who can afford to pay the charges does not necessarily mean that the organisation does not operate for the public benefit; and
- c) an organisation which wholly excluded poor people from any benefits, direct or indirect, would not be established and operate for the public benefit and therefore would not be a charity.

(*ibid*, pages 24-5)

In light of the uncertainty about defining public benefit, the Joint Committee considered whether the Bill should contain or provide for a more explicit public benefit test. It also considered whether, in the longer term, certain fee-charging organisations might be able to retain their tax advantages, while no longer being considered charities under the law, although the Joint Committee was not able to explore the full implications of this proposal. There was little support for the inclusion of a statutory definition of public benefit; the Charity Law Association believed that it would create uncertainty as to how the definition would be interpreted, and the National Council for Voluntary Organisations preferred a non-statutory definition that would enable charity law to evolve over time (*ibid*, paragraph 97). The Joint Committee therefore recommended that the joint position agreed by the Home Office and Charity Commission form the basis of guidance:

... that the basic principles for a definition of public benefit should be those set out in the recent concordat between the Home Office and the Charity Commission ... and that those principles should be replicated

either in non-exclusive criteria included in the Bill or in non-binding statutory guidance issued by the Secretary of State.

(*ibid*, paragraph 102)

In its response, the Government indicated its intention to make provision for the Charity Commission to issue guidance as to the operation of the public benefit test:

The “concordat” that the Joint Committee refers to was a joint letter from Fiona Mactaggart MP, the Minister responsible for the Charities Bill, and Geraldine Peacock, the Chief Charity Commissioner. That letter set out principles that are to be used, in any case where an organisation charges fees for its facilities and services, to judge the impact of the organisation’s fee-charging on its ability to satisfy the public benefit test for charitable status. The letter was not meant to be a full exposition of the public benefit principles applying to charities generally – for example, the letter did not mention the principle that determines whether or not an organisation that provides some private benefit as well as public benefit satisfies the public benefit test. So we do not see the principles in the letter as forming a complete basis for an explanation of public benefit, although they do form a good partial basis.

The Government does not believe that the development of the law on charitable status will be best served by including in the Bill a list of “non-exclusive criteria”. The intention of putting such a list into the Bill would be to set out some of the factors which are to be taken into account by the Charity Commission and the court when considering an organisation’s public benefit. There is a risk that over time the list would come to be seen as representing not some but all of the factors to be taken into account. And we do not believe that enacting a non-exclusive or partial list would fully satisfy the Joint Committee’s own conclusion that “there is a need for a more explicit definition of public benefit in connection with the Bill”.

We therefore prefer the option of having the public benefit principles stated in guidance which explains the law, and aims to generate greater general awareness of what public benefit means in the context of charity, but is not itself part of the law. The advantages of this are that it provides maximum flexibility for the law to develop in response to changes in society and that it allows for all, rather than just some, of the public benefit principles to be set out and explained.

We note the Joint Committee’s comment that giving the Secretary of State the function of preparing guidance risks “leaving the way open to periodic interference by the Government in the definition of what is charitable”. The same risk is identified by the National Council for Voluntary Organisations, who strongly believe that there should be no Government control over any aspect of the definition of charity.

To remove that risk we therefore intend in the Bill to place the guidance-making function not with the Secretary of State but with the Charity Commission as the independent regulator which is not under Government

direction or control. As the definition of charity is a matter of general public interest the Commission will be required in preparing the guidance to consult appropriate persons and bodies. We would expect the Commission to consult as widely as possible. We note also the Joint Committee's suggestion (not expressed as a recommendation of its report) that "the Government should consider reviewing the charitable status of independent schools and hospitals with a view to considering whether the best long-term solution might lie in those organisations ceasing to be charities but receiving favourable tax treatment in exchange for clear demonstration of quantified public benefit." The Government does not accept the suggestion that charitable status should be removed from those organisations. The Charity Commission will ensure that such charities provide public benefit as part of the programme of "public character checks" that it will begin once the Bill has been enacted.

(Cm 6440, paragraph 8)

Accordingly, a clause (clause 4) was added to the Bill requiring the Charity Commission to issue guidance as to the operation of the public benefit requirement.

3.4 Loss of charitable status

In considering the public benefit test, the Joint Committee expressed concern that the draft Bill did not provide sufficient clarity on what would happen to a charity's assets, should it fail to demonstrate public benefit, and thereby lose its charitable status. The Joint Committee stated:

We recommend that the real Bill include provisions to clarify the effect of the loss of charitable status on the assets of a charity. The Government should consider whether the Bill should contain provisions enabling the Charity Commission to agree that trustees in such circumstances can elect to retain their assets and continue to run the organisation, as a not-for-profit organisation without charitable status, for the original purposes.

(HL Paper 167/HC 660, 2003-04, paragraph 105)

The Government did not accept this recommendation:

The Charity Commission's publication *Maintenance of an Accurate Register* explains the effect of the loss of charitable status under the current law, which we believe provides an adequate basis for determining what happens to the assets of an organisation that ceases to be a charity. We do not in any case believe that changes to the current rules should be contemplated without an extensive public consultation on the matter, since any change could have a significant effect on the rights and expectations of anyone who donates money or other assets to charity.

(Cm 6440, paragraph 9)

4. Trading

As noted above, the Government were not persuaded to accept the Strategy Unit's recommendation that charities be allowed to trade directly, without the need for a separate trading company. Consequently, the draft Bill did not include a provision to this effect, the only major point on which the draft Bill did not follow the Strategy Unit's recommendations. The Joint Committee nevertheless considered whether provisions on trading should be included in the Bill.

The Joint Committee summarised the current position concerning 'non-primary purpose' trading as follows:

If the income from this type of trading is small or incidental - i.e., £5,000 or less than 25% of the charity's total income (up to a maximum of £50,000) - then the charity both has the power to trade and is exempt from income tax on trading profits. However, a charity can get around this restriction by setting up a separate trading company to carry on trading; the trading company can then transfer its profits back to the charity under the Gift Aid scheme, so that no tax is paid on them. There are some disadvantages to doing this: mainly that it results in additional paperwork.

(HL Paper 167/HC 660, 2003-04, paragraph 335)

Most of the evidence received by the Joint Committee (including that of the Charity Commission, the Charity Finance Directors' Group, the National Council of Voluntary Organisations, the Association of Chief Executives of Voluntary Organisations, and the Charity Law Association) supported the inclusion in the draft Bill of the Strategy Unit's proposal to allow trading within the charity, subject to a specific statutory duty of care, which would offer the advantage of relieving charities of the bureaucratic burden of having to set up separate trading companies. Against this position, the Federation of Small Businesses argued that the tax breaks enjoyed by charity shops represented unfair competition against small businesses, and the Charity Advisory Trust claimed that trading rarely produced significant income for charities, and that the separate trading company had merit in that it isolated trading activity so that it was easier to see whether it was profitable or loss-making. These arguments were countered by the Charity Finance Directors Group and the Association of Chief Executives of Voluntary Organisations, who suggested that allowing charities to trade directly would not provide any tax advantage that they did not already enjoy, and that the risks associated with trading would apply whether or not it was conducted within charities or by a separate trading company (*ibid*, paragraphs 339-48).

On balance, the Joint Committee considered that further powers for charities to trade were desirable, subject to some limit. Thus it did not adopt the Strategy Unit's recommendation that charities be allowed to conduct unlimited non-primary purpose trading without the need for a trading company, but supported a proposal suggested

by the Association of Chief Executives of Voluntary Organisations to allow trading 'incidental' to the charity. It concluded:

The Committee recommends that the draft Bill should be amended to allow charities to trade within the charity and enjoy tax exemption on trading income up to the point where income from trading equals 25% (or £5,000 if the greater) of the charity's total turnover, but this should be subject to an overall limit higher than the current £50,000 and the Government should consult on the level at which that overall limit should be set.

(*ibid*, paragraph 354)

In its response, the Government stated:

The level of the statutory exemption for small trading is a matter for Finance Bill legislation rather than for the Charities Bill and any changes would be considered as part of the normal Budget process. But any increase in the overall limit would give charities a greater advantage over private sector businesses, especially small and medium sized enterprises. The Government regards the current exemption, together with the extra statutory concession on fundraising events, as sufficient to allow charities to engage in small amounts of trading without the extra administration costs of setting up a subsidiary, but does not give charities a significant advantage over other commercial businesses. An increased limit would mean that considerably more trading could be carried out by charities tax free, giving them a greater competitive advantage over small businesses which are taxed on their profits. Trading companies have the option to donate their profits to charity, and so start from a similar position whether they are subsidiaries of charities or not. It would be unfair to give charities greater exemptions from the requirements normal commercial businesses have to meet. Charities already enjoy advantages over commercial businesses, with relief from tax on profits of primary purpose and ancillary trades as well as the exemption for small trading, and we need to consider the overall impact for businesses.

(Cm 6440, paragraph 42)

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