



**Law  
Commission**  
Reforming the law

## Technical Issues in Charity Law



(Law Com No 375)

# Technical Issues in Charity Law

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## Glossary of terms used in this report

<b>Appropriation</b>	Appropriation is “the process whereby [the person responsible for administering the estate] uses a specific asset to meet in full or in part the pecuniary entitlement of a beneficiary”. <sup>1</sup> When land is appropriated to a beneficiary, the beneficiary acquires the beneficial interest in the property.
<b>Assent</b>	An assent is the transfer of ownership of an asset to a person entitled to that asset pursuant to the administration of a deceased’s estate. It is “an acknowledgement by a personal representative that an asset is no longer required for the payment of the debts, funeral expenses or general pecuniary legacies”. <sup>2</sup>
<b>Beddoe orders</b>	In court proceedings, charity trustees can seek a <i>Beddoe</i> order which provides them with advance assurance that the proceedings are in the interests of the charity and that the costs incurred by the trustees can properly be paid from the charity’s funds.
<b>CAAV</b>	Central Association of Agricultural Valuers
<b>CLA</b>	Charity Law Association
<b>Charity</b>	An institution falling within section 1 of the Charities Act 2011; see para 2.3.
<b>Charity Commission Guidance</b>	Guidance published by the Charity Commission and available on its website. The guidance comes in two series: the “CC” series which is intended for external use, and Operation Guidance (the “OG” series) which is intended for internal use but which provides further detail on the Commission’s approach to many issues.
<b>Charity trustees</b>	Defined in section 177 of the Charities Act 2011 as “those responsible for the control and management of the charity”. It includes the directors of a charitable company and the management committee of an unincorporated association.
<b>CIO</b>	Charitable incorporated organisation: a form of corporate charity that was introduced by the Charities Act 2006 as an alternative to the limited company. It provides the benefits of incorporation without requiring dual registration with both the Charity Commission and with Companies House.
<b>Consultation Paper</b>	The Law Commission’s principal consultation paper on Technical Issues in Charity Law. <sup>3</sup>

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<sup>1</sup> *Williams, Mortimer & Sunnucks on Executors, Administrators and Probate* (20th ed, 2013) para 55-54.

<sup>2</sup> *Williams, Mortimer & Sunnucks on Executors, Administrators and Probate* (20th ed, 2013) para 81-01.

<sup>3</sup> (2015) Law Commission Consultation Paper No 220 available at [http://www.lawcom.gov.uk/app/uploads/2015/06/cp220\\_charities\\_technical.pdf](http://www.lawcom.gov.uk/app/uploads/2015/06/cp220_charities_technical.pdf).



<b>Cy-près</b>	Cy-près means “as near as possible”. When a charitable purpose cannot be carried out, the Charity Commission can direct under a scheme that the funds should be used for other similar charitable purposes.
<b>Designated land</b>	Land held on trusts stipulating that it must be used for the purposes of the charity: Charities Act 2011, section 275(1).
<b>Diocesan glebe land</b>	Land vested under the Endowments and Glebe Measure 1976 in the diocesan board of finance of the Church of England. It is used for investment purposes to generate income for the Diocesan Stipend Fund: Endowments and Glebe Measure 1976, section 15.
<b>Disponee</b>	A person to whom an interest or estate in land is granted or conveyed. For example, a buyer of a freehold or leasehold estate, a tenant under a lease, a chargee, or a person who is granted an easement.
<b>Expendable endowment</b>	Property which is subject to a restriction on being spent, unless and until the trustees decide to spend it; the trustees have a discretion to spend the capital.
<b>Functional permanent endowment</b>	Permanent endowment that generally does not produce an income but is used by the charity to pursue its purposes, for example a village hall or a recreational ground. The charity might be able to sell the property and purchase other property that performs the same function, but it cannot spend the proceeds of any sale on its day-to-day activities.
<b>Governing document</b>	The document setting out a charity’s purposes, the powers and duties of those responsible for its management and administration, and the procedures to be followed in exercising those powers. “Governing document” is used as a generic term, regardless of a charity’s legal form. The Charities Act 2011 uses the term “trusts” to refer to a charity’s governing document, regardless of whether or not it is in fact a trust.
<b>Investment permanent endowment</b>	A fund of assets, such as shares, that produce an income to fund the charity’s activities. The charity can sell an investment in the fund to purchase another, but it cannot sell an investment and spend the proceeds to further its purposes.
<b>NAEA</b>	National Association of Estate Agents
<b>Permanent endowment</b>	Property that is held by, or on behalf of, a charity subject to a restriction on being spent: section 353(3) of the Charities Act 2011.
<b>Residuary gift</b>	The “residue” of an estate is all that is left after the payment of (i) the deceased’s debts, (ii) the expenses of the administration of the estate, and (iii) the payment of legacies. When a testator leaves the residue of the estate to a named person, it is a “residuary gift”.
<b>RICS</b>	Royal Institution of Chartered Surveyors
<b>Royal Charter charities</b>	A charity that is incorporated or regulated by a Royal Charter.

<b>Specific devise</b>	A gift by will of particular land to a named beneficiary.
<b>Statutory charities</b>	A charity that is incorporated or regulated by an Act of Parliament.
<b>Supplementary Consultation Paper</b>	The Law Commission's supplementary consultation paper on Technical Issues in Charity Law. <sup>4</sup>

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<sup>4</sup> (2016) available at [http://www.lawcom.gov.uk/wpcontent/uploads/2016/08/Charity\\_Law\\_Supplementary\\_Cp\\_Sept\\_2016.pdf](http://www.lawcom.gov.uk/wpcontent/uploads/2016/08/Charity_Law_Supplementary_Cp_Sept_2016.pdf).

# Technical Issues in Charity Law

*To the Right Honourable David Lidington MP, Lord Chancellor and Secretary of State for Justice*

## Chapter 1: Introduction

### INTRODUCTION

- 1.1 This report analyses various issues in charity law and makes recommendations that the law should be reformed.

#### What is a charity?

- 1.2 Charities occupy a special place in society and in law. They exist for the benefit of the public.<sup>5</sup> Each has a purpose, ranging from the relief of poverty to the promotion of the arts to the advancement of environmental protection.<sup>6</sup> Charities come in all shapes and sizes, and their aims range from focusing on local issues to a nationwide or global sphere of interest.
- 1.3 It is a fundamental principle that, for an institution to be a charity, its purposes must be exclusively charitable.<sup>7</sup> A charity must exist for the benefit of the public generally, not for the benefit of private individuals or entities.
- 1.4 The Charity Commission for England and Wales registers and regulates charities, though many charities are not required to be registered. Of those unregistered charities, some are nevertheless regulated by the Charity Commission; others are not. We explain these different categories of charity in Chapter 2.

#### The size of the charity sector

- 1.5 There are approximately 167,000 charities in England and Wales registered with the Charity Commission,<sup>8</sup> with a combined annual income of over £74 billion.<sup>9</sup> In 2012, it was estimated that there were a further 191,000 unregistered charities with a combined income of £57.7

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<sup>5</sup> Charities Act 2011, ss 2(1)(b) and 4.

<sup>6</sup> Charities Act 2011, s 3(1) contains a list of charitable purposes.

<sup>7</sup> Charities Act 2011, s 1(1)(a).

<sup>8</sup> Charity Commission, *Charities in England and Wales – 31 March 2017*, available at <http://apps.charitycommission.gov.uk/Showcharity/RegisterOfCharities/SectorData/SectorOverview.aspx>. This comprises 167,422 main charities and 16,087 linked charities.

<sup>9</sup> Charity Commission, *Charities in England and Wales – 31 March 2017*. The figure comprises voluntary income (£22.79 bn), trading to raise funds (£7.41 bn), investment income (£4.03 bn), charitable activities income (£38.37 bn) and other sources (£1.67 bn).

billion.<sup>10</sup> Charities hold significant assets; registered charities alone have total assets worth over £259 billion.<sup>11</sup>

### Trustees, staff and volunteers

- 1.6 Charities depend on people. Charities are overseen and controlled by their trustees, who are generally unpaid. Trustees range significantly from local residents who are passionate about a local cause through to professionals whose skills and experience can assist in the oversight of a large charity's operations. Small charities often rely solely on the trustees and other volunteers to carry out their activities; others have sufficient resources to employ (sometimes numerous) staff. Charity law therefore applies to and affects a wide range of people, many of whom will not have access to legal advice on its application.
- 1.7 There are more than 951,000 trustees of registered charities, and registered charities employ over 1.5 million people and are supported by over 3.5 million volunteers.<sup>12</sup> These figures would increase significantly if the trustees, staff and volunteers of unregistered charities were included (but about whom there are no data).

### Public donations to charities

- 1.8 The importance of charities is reflected by the significant donations made to them each year; charitable giving by individuals in the United Kingdom in 2016 was estimated to be £9.7 billion.<sup>13</sup> According to a 2016 survey conducted by the Cabinet Office, in an average four-week period, around three-quarters of the 3,000 people interviewed gave to a charity, donating an average of £22.<sup>14</sup>

### Public trust and confidence

- 1.9 The Charity Commission's first statutory objective is to increase public trust and confidence in charities.<sup>15</sup> Research published by the Charity Commission in 2016 showed that public trust and confidence in charities had reached its lowest level since 2005.<sup>16</sup> This fall is thought to have been a result of negative media coverage about charities in 2015/16 and a distrust as to how donations were being spent, in particular the proportion of donations which were reaching the end cause.<sup>17</sup> However, research published by nfpSynergy later in 2016 indicated that

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<sup>10</sup> National Audit Office, *Regulating charities: a landscape review* (July 2012) para 1.18, available at [http://www.nao.org.uk/wp-content/uploads/2012/07/Regulating\\_charities.pdf](http://www.nao.org.uk/wp-content/uploads/2012/07/Regulating_charities.pdf). The National Audit Office included exempt and excepted charities, but did not include charities that are unregistered because their income is below £5,000 (see paras 2.14 to 2.18 below). When small unregistered charities are included, these figures will increase.

<sup>11</sup> Charity Commission, *Charities in England and Wales – 31 March 2017*. The figure comprises "own use" assets (£79.90 bn), long term investments (£133.55 bn), short term investments and cash (£33.53 bn) and other assets (£12.76 bn).

<sup>12</sup> Charity Commission, *Charities in England and Wales – 31 March 2017*.

<sup>13</sup> Charities Aid Foundation, *UK Giving 2017* (April 2017) p 10, available at <https://www.cafonline.org/docs/default-source/about-us-publications/caf-ukgiving2014.pdf>. Total donations from individuals and companies in the United Kingdom on which Gift Aid was reclaimed in 2015/2016 were £5.05 bn: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/324131/Table\\_10\\_3.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324131/Table_10_3.pdf) (this does not include donations made outside the Gift Aid scheme).

<sup>14</sup> Cabinet Office, *Community Life Survey 2015 to 2016: data* (July 2016) available at <https://www.gov.uk/government/publications/community-life-survey-2015-to-2016-data>.

<sup>15</sup> Charities Act 2011, s 14.

<sup>16</sup> Charity Commission, *Public trust and confidence in charities 2016* (June 2016) available at <https://www.gov.uk/government/publications/public-trust-and-confidence-in-charities-2016>.

<sup>17</sup> Charity Commission, *Public trust and confidence in charities 2016* (June 2016) p 24.

public trust in charities is returning, rising from 48% in autumn 2015 to 60% in autumn 2016.<sup>18</sup> The most recent research published by the Charity Commission explains that the level of public trust in the charity sector is comparable with that in schooling and childcare and the food and drink industry, and significantly higher than that in other industries such as financial services and affordable housing.<sup>19</sup>

## Charities in the public eye

- 1.10 During the course of our project, there has been significant media coverage relating to charities, principally concerning fundraising practices and the collapse of Kids Company. Fundraising was an issue addressed by a cross-party review in 2015,<sup>20</sup> measures were included in the Charities (Protection and Social Investment) Act 2016,<sup>21</sup> and the new Fundraising Regulator is already operational.<sup>22</sup> Fundraising does not form part of our terms of reference.
- 1.11 The charity Kids Company closed in August 2015 amid allegations of financial mismanagement and governance problems.<sup>23</sup> The Charity Commission opened a statutory inquiry into the charity soon after, in line with its duty to promote public trust and confidence in charities. Various other inquiries have been conducted into the collapse of the charity, including by the Public Accounts Committee and the Public Administration and Constitutional Affairs Committee.<sup>24</sup> These inquiries have focussed on issues surrounding public money granted to the charity without sufficient competitive tendering and assessment of the way in which the charity was run. The Insolvency Service has recently stated its intention to bring proceedings against the former directors of the charity which could disqualify them from acting as company directors.<sup>25</sup> While the concerns raised by the inquiries to date are relevant to the need, in our recommendations, to balance deregulation against proper protection of charity

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<sup>18</sup> NfpSynergy, *Trust in Charities – Autumn 2016 update* (December 2016) available at <https://nfpsynergy.net/press-release/nfpsynergy-trust-charities-report-december-2016>.

<sup>19</sup> Charity Commission, *Trust and confidence in the Charity Commission 2017* (July 2017) available at <https://www.gov.uk/government/publications/trust-and-confidence-in-the-charity-commission-2017>.

<sup>20</sup> Sir Stuart Etherington, *Regulating fundraising for the future: trust in charities, confidence in fundraising regulation* (NCVO, September 2015) available at [https://www.ncvo.org.uk/images/documents/policy\\_and\\_research/giving\\_and\\_philanthropy/fundraising-review-report-2015.pdf](https://www.ncvo.org.uk/images/documents/policy_and_research/giving_and_philanthropy/fundraising-review-report-2015.pdf).

<sup>21</sup> The Charities (Protection and Social Investment) Act 2016, s 13 prohibits commercial fundraisers from raising funds for a charitable institution unless the fund-raising agreement between the commercial fundraiser and the charitable institution includes certain terms in relation to fund-raising standards which the commercial fundraiser undertakes to follow. It also requires charities to set out in their annual reports their approach to fund-raising, including, in particular, whether they use commercial fundraisers, and how they protect vulnerable people from undue pressure in their fund-raising.

<sup>22</sup> The Fundraising Regulator sets and maintains the standards for charitable fundraising, aims to ensure that fundraising is respectful, open, honest and accountable to the public, and regulates fundraising in England, Wales and Northern Ireland.

<sup>23</sup> Eg BBC, “Kids Company closure: what went wrong?” (February 2016) available at <http://www.bbc.co.uk/news/uk-33788415>.

<sup>24</sup> The Government’s funding of Kids Company, Report of the Public Accounts Committee (2015-16) HC 504; and The collapse of Kids Company: lessons for charity trustees, professional firms, the Charity Commission and Whitehall, Report of the Public Administration and Constitutional Affairs Committee (2015-2016) HC 433.

<sup>25</sup> J Grierson, “Kids Company: ex-board members face company directorship ban” (31 July 2017, The Guardian) available at <https://www.theguardian.com/uk-news/2017/jul/31/kids-company-insolvency-service-camila-batmanghelidjh-alan-yentob>.

assets, none of them relate directly to the terms of reference for this project. We therefore do not directly address these issues in this report.

## BACKGROUND TO THE PROJECT

- 1.12 Our project on selected issues in charity law originated from our Eleventh Programme of Law Reform.<sup>26</sup> The Charity Commission had suggested a review of certain issues affecting charities established by statute and by Royal Charter. We were also mindful of the statutory review<sup>27</sup> of the Charities Act 2006 that was about to be conducted by Lord Hodgson of Astley Abbots, which we thought might raise further legal issues that were ripe for reform. Lord Hodgson's report, published in 2012, made over 100 recommendations.<sup>28</sup> Amongst those recommendations, he highlighted various technical legal problems faced by charities and suggested that they be given further consideration by the Law Commission. We agreed to include many of those issues within our project, which started in 2013. Our terms of reference are set out in Appendix 1.
- 1.13 We divided the project into two parts. The first part concerned social investment by charities; the second the remaining issues in our terms of reference.

### Social investment by charities

- 1.14 We published a Consultation Paper on social investment by charities in April 2014<sup>29</sup> and a paper setting out our recommendations in September 2014 ("the Social Investment Report").<sup>30</sup> We then drafted a Bill to give effect to our principal recommendations (a) for the creation of a statutory power for charities to make social investments, and (b) to set out the duties that should apply when charity trustees make social investments. Our draft Bill has since been implemented as part of the Charities (Protection and Social Investment) Act 2016, subject to one modification.<sup>31</sup>

### Technical issues in charity law

- 1.15 This report concludes the second part of our project covering all the remaining issues in our terms of reference. We also added one issue that arose from our work on social investment, namely a review of the law relating to the use of permanent endowment.
- 1.16 Our project is not a full review of charity law. Our terms of reference relate to selected technical issues. Those issues do not include controversial matters, such as the law of public benefit and the charitable status of independent schools. Lord Hodgson made recommendations in

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<sup>26</sup> Eleventh Programme of Law Reform (2011) Law Com No 330, available at <https://www.lawcom.gov.uk/document/programmes-of-law-reform/>.

<sup>27</sup> See Charities Act 2006, s 73.

<sup>28</sup> Lord Hodgson of Astley Abbots, *Trusted and Independent: Giving charity back to charities – Review of the Charities Act 2006* (July 2012) available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/79275/Charities-Act-Review-2006-report-Hodgson.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79275/Charities-Act-Review-2006-report-Hodgson.pdf). We refer to this report as the "Hodgson Report".

<sup>29</sup> Social Investment by Charities (2014) Law Commission Consultation Paper No 216.

<sup>30</sup> Social Investment by Charities: The Law Commission's Recommendations (September 2014) ("the Social Investment Report") available at <https://www.lawcom.gov.uk/project/charity-law-social-investment-by-charities/>.

<sup>31</sup> Our recommendation was that the power and duties should apply to all charities, including those established or governed by an Act of Parliament or Royal Charter (which we refer to as statutory charities and Royal Charter charities; see Ch 2). Government decided to exclude statutory and Royal Charter charities from the new social investment power and duties, leaving them instead to rely on the existing powers in their governing document or to seek an amendment to their governing documents. We make recommendations concerning the amendment of such charities' governing documents in Ch 5.

respect of some of the issues within our terms of reference; others he simply highlighted as creating difficulties and worthy of more detailed consideration by the Law Commission. In formulating our recommendations for reform, we have carefully considered Lord Hodgson's comments and (when he made them) his recommendations. Our review has not, however, been limited to an assessment of his recommendations. Rather, we have looked afresh at the various issues in our terms of reference including their wider context.

## THE AIMS OF REFORM

- 1.17 Our project concerns various technical legal issues in charity law. Whilst technical, they are important and have very practical consequences for charities. Lord Hodgson has likened regulatory burdens on charities to the barnacles that slow down a ship.<sup>32</sup> Uncertainties in the law and unnecessary regulation can delay or prevent charities' activities, discourage people from volunteering to become trustees, and force charities to obtain expensive legal advice. And whilst some (particularly large) charities have ready access to legal advice, it is beyond the reach of others.
- 1.18 Charities have an important role and the law should both protect and properly regulate them. Our project is intended to further these objectives by removing unnecessary or inefficient regulation while safeguarding the public interest in ensuring that charities are properly run.<sup>33</sup> Charities must be carefully regulated, but not every regulatory requirement is indispensable. For example, in Chapter 7 we recommend relaxing, but not removing, the regulation of land transactions by charities; rather than requiring charities to obtain advice from members of the Royal Institution of Chartered Surveyors ("RICS"), we recommend that charities should also be able to satisfy the regulatory requirements by obtaining advice from certain other property professionals.
- 1.19 Our recommendations aim to support and equip the charity sector by ensuring that the legal framework in which it operates is fair, modern, simple and cost effective. More specifically the recommendations aim to fulfil the following objectives.
  - (1) To remove unnecessary regulation and bureaucracy in order to maximise the efficient use of charitable funds. The aim is to prevent the disproportionate diversion of charitable assets and trustee time on compliance with regulation from which little or no benefit is derived.
  - (2) To increase the flexibility of trustees to make decisions in the best interests of their charities, in particular to give trustees wider or additional powers to make decisions without having to obtain authorisation where appropriate.
  - (3) To confer wider or additional powers on the Charity Commission in order to increase its effectiveness. This includes enabling the Commission to carry out its current functions more efficiently and to take action where it ought to be able to but cannot currently (for example to regulate or assist charities).

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<sup>32</sup> Trusts (Capital and Income) Bill [HL], Report of the Special Public Bill Committee (2012) HL Paper 42, p 50: "Each barnacle has very little effect. Trying to chip off one barnacle leaves one open to the accusation that one is either obsessive, irresponsible or lacking in judgment as to the use of parliamentary time, or possibly all three at once. In consequence, if one is tempted to leave all the barnacles in place, eventually the ship slows down."

<sup>33</sup> Consultation Paper, para 1.9.

- (4) To ensure adequate protection of charity property in order to enhance donor confidence and public trust, in particular supporting confidence in the use of donations currently and in the future.
- (5) To remove inconsistencies and complexities in the law making it clearer for charity trustees, staff, volunteers and professional advisers seeking to apply it and comply with it as well as reducing legal and other professional costs. This includes seeking to reduce the potential for unintentional mistakes and the associated costs of addressing them.

1.20 There is a link between good regulation and public trust and confidence in charities. Speaking at the Charity Commission’s Annual Public Meeting in 2017, the Chair of the Charity Commission, William Shawcross, said that the Commission wished to add to its focus on compliance “a renewed emphasis on enablement.” He argued that “enabling trustees to run their charities better is key to public confidence in charity and to the effective use of charitable resources.”

## CONSULTATION

1.21 In March 2015 we published our consultation paper, Technical Issues in Charity Law (“the Consultation Paper”)<sup>34</sup> which made proposals to:

- (1) give charities wider or additional powers and flexibility;<sup>35</sup>
- (2) reduce the regulation of certain transactions by charities;<sup>36</sup>
- (3) confer wider or additional powers on the Charity Commission;<sup>37</sup> and
- (4) rationalise the law and remove inconsistencies.<sup>38</sup>

1.22 Two issues arose from the consultation on which we did not expressly invite consultees’ views: first, a particular point relating to changing a charity’s purposes; and second, trust corporation status. We wanted to hear more about these issues before deciding on our final recommendations. We therefore published a supplementary consultation paper (“the Supplementary Consultation Paper”)<sup>39</sup> in September 2016 focussing on those two issues.

1.23 Consultees were supportive of our project and keen to engage in the detail of our proposals. There was a clear sense that the issues in our project, although technical and difficult, are

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<sup>34</sup> Technical Issues in Charity Law (2015) Law Commission Consultation Paper No 220, available at <http://www.lawcom.gov.uk/project/charity-law-technical-issues-in-charity-law/>.

<sup>35</sup> For example, to change their purposes and amend their governing documents, to pay trustees for the supply of goods, and to make small payments that they have a moral – but not legal – obligation to make without Charity Commission oversight.

<sup>36</sup> For example, the sale of charity land and the release of permanent endowment restrictions.

<sup>37</sup> For example, the power to award an equitable allowance to a trustee who is liable to account for profits made in breach of fiduciary duty and the power to require charities to change their name.

<sup>38</sup> For example, creating a power to pay trustees for the supply of goods that corresponds with the power to pay trustees for the provision of services and conferring on the Charity Tribunal the same power as the court to authorise the expenditure of charitable funds on proceedings before the Tribunal.

<sup>39</sup> Technical Issues in Charity Law Supplementary Consultation (2016) available at [http://www.lawcom.gov.uk/wp-content/uploads/2016/08/Charity\\_Law\\_Supplementary\\_Cp\\_Sept\\_2016.pdf](http://www.lawcom.gov.uk/wp-content/uploads/2016/08/Charity_Law_Supplementary_Cp_Sept_2016.pdf).



nevertheless important for charities and that reform has the potential to improve the legal framework within which charities operate.

1.24 Many consultees commented on the need for a balance between various competing interests in devising recommendations for reform.

- (1) Charities should be given flexibility and autonomy in how they are run.
- (2) “Inefficient and unduly complex legal provisions that impose unnecessary administrative and financial burdens on charities” should be removed.<sup>40</sup>
- (3) Proper oversight and accountability of charities is important to maintain public trust and confidence in the sector.
- (4) Regulation should be proportionate; “a regulatory regime whose administrative costs swallow up a large part of the benefit is inappropriate”.<sup>41</sup>
- (5) Deregulation can be beneficial for all charities; small charities, in particular, might benefit from reduced compliance costs. Conversely, however, “good regulation can be helpful for smaller charities, providing a proper structure within which to operate”.<sup>42</sup>
- (6) Third party rights should be respected, but should not unduly hamper the administration of a charity or prevent change.

1.25 There is often a tension between these aims, and we agree with consultees’ general comments about the need for a balance. The difficulty is in deciding how to reach the balance between those competing aims.

### Consultation events

1.26 During the consultation period, we attended various consultation events:

- (1) a public consultation event in Bristol, hosted by Veale Wasbrough Vizards LLP;
- (2) a consultation event for charity professionals, practitioners and academics, organised and hosted by the University of Liverpool Charity Law and Policy Unit, at the University’s London campus; and
- (3) meetings with the Association of University Legal Practitioners, the Association of Charitable Foundations, the National Council for Voluntary Organisations, the Charities’ Property Association, the Churches’ Legislation Advisory Service, and officials from the Privy Council Office, Attorney General’s Office, Department for Business, Innovation and Skills (as it then was), and the Welsh Government.

1.27 The Consultation Paper also featured in the sector press.<sup>43</sup>

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<sup>40</sup> Wales Council for Voluntary Action.

<sup>41</sup> The Hodgson Report.

<sup>42</sup> CLA working party; similar comments were made by Action with Communities in Rural England.

<sup>43</sup> Civil Society, “What are the key proposals from the Law Commission review of charity law?” (1 May 2015) available at [http://www.civilsociety.co.uk/finance/indepth/technical\\_briefing/content/19530/what\\_are\\_the\\_key\\_proposals\\_from\\_the\\_law\\_commission\\_review\\_of\\_charity\\_law](http://www.civilsociety.co.uk/finance/indepth/technical_briefing/content/19530/what_are_the_key_proposals_from_the_law_commission_review_of_charity_law); and Third Sector, “Law Commission starts review of charity law”

## Consultation responses

- 1.28 We had an enthusiastic response to our consultations. We received written responses to our initial consultation from 91 consultees and an additional 26 written responses to our supplementary consultation, many of which were very detailed. The consultees who responded are listed in Appendix 2. All of the main stakeholders in the charity sector were represented.<sup>44</sup>
- 1.29 The Charity Law Association (“CLA”) formed a working group of 23 charity lawyers to respond to the Consultation Paper, and two further working groups to respond to the Supplementary Consultation Paper. Those responses have been particularly helpful in devising our recommendations for reform. The views of the working group do not necessarily represent the opinions of the CLA membership, nor the organisations that each lawyer represents. For brevity, however, we refer to the responses of the CLA working groups as the response of “the CLA”.
- 1.30 We have held follow-up meetings with members of the CLA working group, the Charity Commission, the Charities’ Property Association and the institutions governed by the Universities and College Estates Act 1925 to discuss aspects of their responses and our recommendations for reform.

## OUR RECOMMENDATIONS FOR REFORM

- 1.31 Consultation revealed general consensus on some issues and a range of views on others. Not everyone will agree with all of our recommendations for reform, but consultation has successfully elicited the different viewpoints which has been helpful to us in formulating our recommendations. On many issues, we follow our provisional proposals in the Consultation Paper, but in some areas we have departed from them following comments from our consultees. The input of consultees has been vital to the preparation of all of our final recommendations for reform.

## THE STRUCTURE OF THIS REPORT

- 1.32 In Chapter 2, we explain the different legal forms of charities and the categorisation of different charities under the Charities Act 2011. In Chapter 3, we comment on a general point raised by some consultees about financial thresholds in the Charities Act 2011.
- 1.33 In Chapters 4 and 5, we discuss the amendment of charities’ purposes and other provisions in their governing documents. Chapter 4 concerns the most common legal forms of charities, and we make recommendations to align more closely the amendment powers of corporate and unincorporated charities. Chapter 5 concerns charities that are governed by statute or by Royal Charter and we make recommendations to improve the procedures by which they can amend their governing documents. In Chapter 6, we examine the rules governing the distribution of the proceeds of failed fundraising appeals.
- 1.34 In Chapter 7, we discuss the regime that applies to charities when they dispose of land. We then turn to the law governing the use of permanent endowment in Chapter 8; we recommend changes to the procedures by which charities can release the restrictions on spending their

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(8 April 2013) available at <http://www.thirdsector.co.uk/law-commission-starts-review-charity-law/governance/article/1177394>.

<sup>44</sup> We did not receive responses from small charities. Many consultees did, however, represent a wide range of charities, including small charities, or have experience of working with small charities; they were able to comment specifically on the issues that small charities face.

permanent endowment and recommend the creation of a new statutory power to borrow from permanent endowment as well as a new power to make certain social investments using permanent endowment.

- 1.35 Chapter 9 addresses two issues: the payment of trustees for the provision of goods to their charity and empowering the Charity Commission to award an equitable allowance to a trustee who has made an unauthorised profit in breach of his or her fiduciary duties to the charity. In Chapter 10 we recommend changes to the circumstances in which ex gratia payments (payments to third parties who have a moral, but not a legal, claim to the charity's property) can be made by a charity.
- 1.36 In Chapter 11, we consider the regime that governs the incorporation and merger of charities, and consider a related issue concerning trust corporation status. We then look at the insolvency treatment of property held on charitable trust, including permanent endowment and special trust property (Chapter 12).
- 1.37 Chapters 13 and 14 concern two discrete powers of the Charity Commission: the power to require a charity to change its name and to refuse to register a charity unless it changes its name (Chapter 13); and the power to determine the identity of the charity's trustees and members (Chapter 14). We make recommendations that these powers be expanded.
- 1.38 In Chapter 15, we discuss particular issues that have arisen since the Charity Tribunal was established by the Charities Act 2006 and make recommendations for reform.
- 1.39 Chapter 16 gathers together all of our recommendations for reform.
- 1.40 Appendix 1 sets out the terms of reference for our project. A list of all consultees appears at Appendix 2.
- 1.41 Appendix 3 contains a draft Bill that would implement our recommendations for reform, and accompanying Explanatory Notes appear at Appendix 4. Appendices 5 and 6 contains draft statutory instruments that would implement those of our recommendations that require secondary legislation. Appendix 7 summarises the means of challenging decisions of the Charity Commission, which is discussed in Chapter 9. Appendix 8 contains some worked examples about the law of insolvency that relate to Chapter 12.
- 1.42 Alongside this report, we are publishing:
  - (1) a summary of this report;
  - (2) a marked-up version of the Charities Act 2011, reflecting the amendments that would be made to the Act following implementation of the draft Bill at Appendix 3 to this report;
  - (3) an Impact Assessment; and
  - (4) an Analysis of Responses to the Consultation Paper and the Supplementary Consultation Paper.
- 1.43 Each of these documents is available on our website: [www.lawcom.gov.uk](http://www.lawcom.gov.uk).
- 1.44 All websites referred to in this report were last visited and correct on 24 August 2017.

## **ACKNOWLEDGEMENTS**

- 1.45 Our thanks go to all those who responded to our two consultation papers (listed in Appendix 2) or who have supported our project in other ways. We are grateful for the work, time and careful thought they have given to the detailed issues covered in this report. We are also grateful to those listed in paragraph 1.26 above who have organised and hosted consultation events which enabled us to engage with a wide range of stakeholders.
- 1.46 Throughout our project we have been assisted by those consultees listed above who have generously given their time to meet with us and discuss some of the most difficult aspects of this area of law and offer feedback on our recommendations. Particular thanks go to our consultants, Con Alexander, Rachel Tonkin and the members of the charities team at Veale Wasbrough Vizards LLP for sharing their expert views on the issues discussed in this paper and on early drafts of this report and Bill; the CLA Working Party, and its Chair Nicola Evans (of Bircham Dyson Bell LLP), for meeting with us on various occasions, for their comments on an early draft of the Bill and for their input for our Impact Assessment; and to Judge McKenna, Principal Judge of the First-tier Tribunal (Charity) for sharing her expertise on our reforms regarding the Charity Tribunal.
- 1.47 Finally, we thank the officials from the Department for Digital, Culture, Media and Sport, the Charity Commission, the Attorney General's Office, the Privy Council Office, the Ministry of Justice, the Tribunal Procedure Committee, the Welsh Government, HM Land Registry, the Department for Education and the Department for Environment, Food and Rural Affairs, who have given detailed feedback on our recommendations and valuable input for our Impact Assessment.

## **THE TEAM WORKING ON THE PROJECT**

- 1.48 The following members of the Property, Family and Trusts team have contributed to this report at various stages: Matthew Jolley (team manager); Daniel Robinson (team lawyer); Elizabeth Drummond (team lawyer); Kimberley Ziya (research assistant); Emma Loizou (research assistant); and James Linney (research assistant).

# Chapter 2: The different types of charity

## INTRODUCTION

2.1 In order to understand our recommendations for reform of charity law, it is important to be familiar with the different legal forms that charities can take as well as the categorisation of charities in the Charities Act 2011.

## THE DIFFERENT LEGAL FORMS OF CHARITIES

2.2 Charities take various different legal forms. Several of the technical issues raised in this report turn on the legal form of the charity, particularly whether it is incorporated (and therefore has a legal personality separate from its trustees or members) or unincorporated (and therefore has no separate legal personality).

### The statutory definition of a charity

2.3 Section 1(1) of the Charities Act 2011 defines “charity” as an institution that is established for charitable purposes only, and falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities. This definition does not distinguish between the different legal forms of charities<sup>45</sup> and the Charities Act 2011 applies to all charities regardless of their legal form.<sup>46</sup>

### Incorporated charities

#### Companies

2.4 Charities can be incorporated as companies. They are governed by the Companies Act 2006 and must be registered at Companies House (as well as being registered by the Charity Commission).<sup>47</sup> Charitable companies are usually limited by guarantee, rather than by shares. A charitable company’s governing document is its articles of association. The Charity Commission publishes model articles of association for charitable companies.<sup>48</sup>

#### Charitable incorporated organisations

2.5 The charitable incorporated organisation (“CIO”) is a new form of incorporated charity that was introduced by the Charities Act 2006 as an alternative to the limited company. It provides the benefits of incorporation without requiring dual registration with both the Charity Commission and with Companies House. The membership of a CIO may be limited to its trustees (the “foundation” model), or it may have members who are not trustees (the “association” model).

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<sup>45</sup> Charities Act 2011, s 9(3).

<sup>46</sup> Although some provisions do not apply to certain categories of charity: see para 2.13 to 2.18 below.

<sup>47</sup> Unless they are not required to register with the Charity Commission: see para 2.14 below.

<sup>48</sup> Charity Commission, *Model articles of association for a charitable company* (August 2014) available at <https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents>.

A CIO's governing document is called its constitution. The Charity Commission publishes a model constitution for CIOs.<sup>49</sup>

#### Charities incorporated by Act of Parliament

2.6 A small number of charities have been incorporated by Act of Parliament. The incorporating Act will often contain the provisions regulating the purposes and administration of the charity, but some of these provisions may be found in a later Act or Acts (or indeed in another instrument). We discuss charities incorporated by Act of Parliament, which we refer to as "statutory charities", in Chapter 5.

#### Charities incorporated by Royal Charter

2.7 A charity (or the governing body of a charity) may be incorporated by a Royal Charter granted by the Sovereign.<sup>50</sup> Charters are granted on the advice of the Privy Council, which advises on the exercise of the Sovereign's duties and common law powers. Like other corporate bodies, Royal Charter corporations are legal persons distinct from their individual members.<sup>51</sup> The governing documents of charities (or trustee bodies) incorporated by Royal Charter typically comprise the incorporating Charter (and any supplemental Charters), bye-laws and regulations. We discuss Royal Charter charities in Chapter 5.

#### Community benefit societies

2.8 Community benefit societies, previously known as industrial and provident societies, can be charities and are governed primarily by the Co-operative and Community Benefit Societies Act 2014.

#### Other incorporated charities

2.9 Charities have occasionally been incorporated by prescription, by a lost Charter being presumed, and by custom.<sup>52</sup>

### Unincorporated charities

2.10 An unincorporated charity will either be a trust or an unincorporated association.

#### Trusts

2.11 A charitable trust involves one or more trustees holding property on trust for charitable purposes. The charity has no members. The governing document will generally be a trust deed or declaration of trust but it may also be a Charity Commission scheme,<sup>53</sup> a will or other

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<sup>49</sup> Charity Commission, *Model constitution for CIO with voting members other than its charity trustees* (October 2016) and *Model constitution for CIO whose only voting members are its charity trustees* (October 2016) available at <https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents>.

<sup>50</sup> At common law, the Sovereign has the power to incorporate by Royal Charter any number of persons assenting to be so incorporated: see *The Case of Sutton's Hospital* [1612] 77 ER 937; and *Elve v Boynton* [1891] 1 Ch 501, 507, by Lindley LJ.

<sup>51</sup> *Re Sheffield and South Yorkshire Permanent Building Society* [1889] QB 470, 476, by Cave J.

<sup>52</sup> See *Tudor on Charities* (10th ed 2015) ch 6; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) ch 18; *Re Fraternity of Free Fishermen of Faversham (Company or Fraternity)* [1877] 36 Ch 329; *Byrd v Wilsford* (1596) Cro Eliz 464.

<sup>53</sup> See para 4.37 and following below.

document setting out the terms of the trust.<sup>54</sup> The Charity Commission publishes a model trust deed for charitable trusts.<sup>55</sup>

#### Unincorporated associations

2.12 An unincorporated association has been described as “an association of persons bound together by identifiable rules and having an identifiable membership”.<sup>56</sup> The rules of the association contain the contractual rights and obligations enforceable by the members against one another. The rules of a charitable unincorporated association usually provide for the management of the affairs of the charity to be the responsibility of a committee elected by the members.<sup>57</sup> The governing document is called a constitution. The Charity Commission publishes a model constitution for unincorporated associations.<sup>58</sup>

### DIFFERENT CATEGORIES OF CHARITY UNDER THE CHARITIES ACT 2011

2.13 There are four categories of charity under the Charities Act 2011, and the application of the Act to any given charity depends on the category into which it falls. The legal form of a charity (see paragraphs 2.4 to 2.12) has no bearing on its categorisation under the Act.

#### Registered charities

2.14 Every charity must register with the Charity Commission, unless it is:

- (1) an exempt charity (see paragraph 2.15);
- (2) an excepted charity with an annual income of £100,000 or less (see paragraph 2.16);<sup>59</sup>  
or
- (3) a charity with an annual income of £5,000 or less (see paragraph 2.18).<sup>60</sup>

#### Exempt charities

2.15 Certain charities are exempt from the requirement to register with the Charity Commission, and from other (but not all) provisions of the Charities Act 2011.<sup>61</sup> They are usually regulated by another body (the “principal regulator”) whose functions overlap with those of the

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<sup>54</sup> On occasion, a trust might be created by informal means, such as long user: see *Tudor on Charities* (10th ed 2015), paras 6-003 and 6-004.

<sup>55</sup> Charity Commission, *Model trust deed for a charitable trust* (November 2013) available at <https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents>.

<sup>56</sup> *Re Koepler's Will Trusts* [1986] Ch 423, 434, by Slade LJ.

<sup>57</sup> *Tudor on Charities* (10th ed 2015) para 6-048.

<sup>58</sup> Charity Commission, *Model constitution for an unincorporated charity* (November 2013) available at <https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents>.

<sup>59</sup> The Charities Act 2011 makes provision for excepted and small charities, but not exempt charities, to register voluntarily (s 30(3)) but that provision has not yet been brought into force: sch 9, para 8 (the equivalent provision in the Charities Act 1993, s 3A(6), was never brought into force).

<sup>60</sup> Charities Act 2011, s 30(2). CIOs, however, must register regardless of their income level.

<sup>61</sup> Those provisions have been extended to certain exempt charities, referred to as “specified exempt charities”: see Appendix A to the Consultation Paper.

Commission. Exempt charities are listed in Schedule 3 to the Charities Act 2011.<sup>62</sup> They include:

- (1) most English universities;<sup>63</sup>
- (2) other educational bodies, such as higher and further education corporations, academies, and foundation and voluntary schools;<sup>64</sup> and
- (3) various museums and galleries, such as the Victoria and Albert Museum, the Science Museum and the British Museum.<sup>65</sup>

### Excepted charities

2.16 Certain charities are “excepted” from charity registration by an order of the Secretary of State or of the Charity Commission.<sup>66</sup> Unlike exempt charities they are still regulated by the Charity Commission in the same way as regular charities. Excepted charities include:

- (1) some churches and chapels;
- (2) some charities that provide premises for schools;
- (3) Scout and Guide groups; and
- (4) certain armed forces charities.<sup>67</sup>

2.17 However, even if a charity is granted “excepted” status, it is nevertheless required to register with the Charity Commission if its income is over £100,000.

### Other unregistered charities

2.18 Charities with an annual income of £5,000 or less are not required to register with the Charity Commission,<sup>68</sup> unless they are CIOs which must register with the Commission regardless of income.

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<sup>62</sup> See also Charity Commission, *Exempt Charities* (CC23) (September 2013) para B6, available at <https://www.gov.uk/government/publications/exempt-charities-cc23>.

<sup>63</sup> Charities Act 2011, sch 3, paras 2 to 5. The principal regulator of these charities is currently the Higher Education Funding Council for England (and will soon become the Office for Students). Welsh universities are not exempt and are therefore regulated by the Charity Commission: see Charity Commission, *Exempt Charities* (CC23) (September 2013) para B6.

<sup>64</sup> Charities Act 2011, sch 3, paras 5 to 11. The principal regulator of these charities is the Department for Education, the Department for Business, Energy & Industrial Strategy or the Welsh Government.

<sup>65</sup> Charities Act 2011, sch 3, paras 12 to 25. The principal regulator of these charities is DCMS, save for the Royal Botanic Gardens, Kew, for which the principal regulator is the Department for the Environment, Food and Rural Affairs.

<sup>66</sup> There are restrictions on the creation of new excepted charities: Charities Act 2011, s 31.

<sup>67</sup> See Charity Commission, *Excepted Charities* (June 2014), available at <https://www.gov.uk/government/publications/excepted-charities>.

<sup>68</sup> Indeed, they are not yet permitted to be registered: s 30(3)(b) of the Charities Act 2011, which would permit such charities to register voluntarily, has not yet been brought into force.



## **TERMINOLOGY**

2.19 This report discusses various technical legal issues and it is sometimes unavoidable that technical legal or sector specific terms are used. We define these terms in the Glossary at pages 1 to 3 of this report but highlight three key definitions here.

### **Charities**

2.20 References to “charities” in this report are to all institutions falling within section 1 of the Charities Act 2011, unless we expressly refer to a particular legal form of charity.

### **Trustees**

2.21 Section 177 of the Charities Act 2011 defines those responsible for the control and management of charities as “charity trustees”. We refer to them as “charity trustees” or just “trustees”. Not all of those who control and manage charities are trustees as a matter of trust law; for example, charitable companies are run by directors, not trustees. Nevertheless, the terms “charity trustee” and “trustee” are widely accepted as covering all those who run charities, including directors. We use the term “trustee” in that sense, save where we make clear that we are referring specifically to the trustees of a trust.

### **Governing documents**

2.22 A charity’s governing document sets out (amongst other things) its purposes, the powers and duties of those responsible for its management and administration, and the procedures to be followed in exercising those powers. We use this as a generic term for the rulebook of all charities, whatever their legal form. The Charities Act 2011 uses the term “trusts” to refer to a charity’s governing document, regardless of whether or not it is in fact a trust.<sup>69</sup>

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<sup>69</sup> Charities Act 2011, s 353(1).

# Chapter 3: Financial thresholds

## INTRODUCTION

- 3.1 In the Consultation Paper, we reviewed some of the existing financial thresholds in the Charities Act 2011 and proposed the creation of others. In this chapter, we address the general comments made by some consultees about the difficulties that are created by financial thresholds.
- 3.2 There are numerous financial thresholds in the Charities Act 2011. For example:
- (1) the statutory requirement to register depends on whether the charity's annual income exceeds £5,000 and, in the case of an excepted charity, whether its annual income exceeds £100,000;<sup>70</sup>
  - (2) registered charities must state that they are registered charities in documentation soliciting money if their annual income exceeds £10,000;<sup>71</sup>
  - (3) the reporting and accounting requirements differ depending on the charity's annual income;<sup>72</sup> and
  - (4) the availability of various powers depends on a charity's income or the value of its capital.<sup>73</sup>
- 3.3 There is often a power for these financial thresholds to be changed by secondary legislation, although such a power is rarely used.<sup>74</sup> Our project includes consideration of the income thresholds in sub-paragraph (4) above.

## ARBITRARY RESULTS FROM THRESHOLDS

- 3.4 The CLA said that income thresholds can produce arbitrary results. They do not exclude a charity with "very significant assets which yield little or no income". They can also be variable in their application, with the same charity falling below the threshold in one year and above the next, or a charity might fall below the threshold fortuitously by shortening its financial year.
- 3.5 We agree that financial thresholds can produce arbitrary results. Many of the statutory provisions that include financial thresholds fall outside our terms of reference.<sup>75</sup> Where provisions that include financial thresholds fall within our project, our recommendations

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<sup>70</sup> Charities Act 2011, s 30(2).

<sup>71</sup> Charities Act 2011, s 39.

<sup>72</sup> Charities Act 2011, ss 132, 133, 144, 145, 162, 163 and 169.

<sup>73</sup> Charities Act 2011, ss 268, 275, 281, 282, 288 and 289.

<sup>74</sup> See, most recently, Charities Act 2011 (Accounts and Audit) Order 2015 SI 2015 No 321 which increased the audit threshold from £500,000 to £1 million.

<sup>75</sup> Principally, those in para 3.2(1), (2) and (3).

would remove some of the arbitrariness that they would otherwise produce.<sup>76</sup> Our recommendations do, however, continue to distinguish between large and small charities so it is inevitable that some arbitrary results, as identified by the CLA, will remain. We think that it can be helpful to have different regulatory regimes for different sized charities, and financial thresholds are the best way to create a simple and clear rule to determine whether a charity or a fund is “small”; indeed, there is no obvious alternative. Moreover, income thresholds will continue to exist elsewhere in the Charities Act 2011 (where they are intended to differentiate between different sizes of charity), particularly concerning registration, accounting and reporting.

## ADJUSTING THE THRESHOLDS TO REFLECT INFLATION

- 3.6 Lord Hodgson noted that “wherever the statutes have specific monetary amounts there is the challenge of declining ‘value’. ... It would be helpful for an automatic inflation adjuster to be built in to the regulations.” The CLA made similar comments and said that financial thresholds “tend not to be reviewed and updated with any regularity, or at all” so any recommendation to increase, or introduce, any threshold will be “in effect, set in stone”.
- 3.7 We acknowledge these concerns about financial thresholds in legislation; they do not keep pace with inflation, and (depending on Governmental priorities and resources) they might rarely be reviewed, let alone increased. We note that the financial thresholds in the Charities Act 2006 with which our project is concerned have not been increased in the 10 years since that Act was passed.<sup>77</sup> We can therefore see the advantages of Lord Hodgson’s suggestion.
- 3.8 We make one recommendation to increase an existing financial threshold which does not, in fact, reflect changes to the value of money caused by inflation, but rather a desire to expand the scope of a power so as to include more charities.<sup>78</sup> But having set that new threshold, and having created others,<sup>79</sup> should they be increased in line with inflation?
- 3.9 We have considered possible mechanisms to incorporate inflation adjustment into the statutory financial thresholds within the scope of our project. For example, the Inheritance and Trustees’ Powers Act 2014 gives effect to a previous Law Commission recommendation that the statutory legacy of £250,000 for a surviving spouse on intestacy (where the deceased also had children) should be increased every 5 years in line with inflation, rounded up to the nearest £1,000.<sup>80</sup> The Lord Chancellor is required to make an order specifying the amount of the statutory legacy at least every 5 years.<sup>81</sup>

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<sup>76</sup> For example, we recommend the repeal of the s 275 power, whose availability depends on the charity’s income (paras 4.28 and following and 4.116 and following), and we recommend the removal of the income threshold (but retention of a capital threshold) under ss 281 and 282 (paras 8.66 to 8.96).

<sup>77</sup> Others have been; see n 74 above.

<sup>78</sup> Paras 8.86 to 8.88.

<sup>79</sup> For example, see Ch 10 concerning ex gratia payments.

<sup>80</sup> Administration of Estates Act 1925, sch 1A, inserted by the Inheritance and Trustees’ Powers Act 2014, s 2 and sch 1. See Intestacy and Family Provision Claims on Death (2011) Law Com No 331, paras 2.114 to 2.130.

<sup>81</sup> Administration of Estates Act 1925, sch 1A, para 5.

It would be possible to provide that the financial thresholds in the Charities Act 2011 should similarly be increased in line with inflation at least every 5 years.

- 3.10 As noted above, many financial thresholds in the Charities Act 2011 fall outside our terms of reference, so we cannot recommend the incorporation of a statutory inflation adjustment mechanism into them. Some consultees emphasised that the drive should be towards consistency between the thresholds rather than divergence between them. It would be inconsistent to introduce a statutory inflation adjustment mechanism only for those financial thresholds in the Act that fall within our terms of reference.
- 3.11 However, even if all thresholds fell within our terms of reference, we would be cautious about automatic inflation adjustment. There are numerous financial thresholds in the Charities Act 2011 and they perform various different roles. Unlike the statutory legacy on intestacy, the financial thresholds determine the regulatory obligations of charities and the availability of various powers.
- 3.12 For financial thresholds that have regulatory implications (as opposed to determining the availability of enabling powers), it is important that any changes are widely publicised. There is also benefit in such a threshold being a simple, round number that does not change regularly to avoid confusion, complexity, and compliance and administration costs. We are not convinced that it would be helpful for these thresholds to change by small amounts on a regular basis. For example, we do not think that charities and their advisers would wish to see the threshold above which excepted charities must register change from £100,000 now to £105,000, and then to £108,000 a few years later, and then to £115,000, and so on. Each time thresholds change, it is necessary for charities and professional advisers to spend time becoming familiar with the changes, and for the Charity Commission and other bodies to issue revised guidance to reflect the changes.
- 3.13 Similarly, even if automatic inflation adjustment was limited to facilitative powers without regulatory implications, regular changes to the thresholds would still have the potential to cause confusion, complexity, and compliance and administration costs, potentially for little benefit (for example, in times of low inflation).
- 3.14 We do not therefore think that it would be helpful for there to be an automatic inflation adjustment mechanism built into the Act in relation to all, or particular categories of, financial thresholds. We do however think that it would be helpful for all financial thresholds in the Act to be reviewed periodically with a view to increasing them to reflect inflation. Such a review could be every five or ten years, or more frequently at times of high inflation.
- 3.15 We think that this approach would enable Government to make a considered decision about whether inflation adjustment is appropriate, rather than it being automatic. It would balance the desirability of keeping the thresholds up to date against the desirability of simplicity in the overall regime, ensuring consistency, and avoiding unnecessary costs caused by a transition to an amended regime. For example, charities with an income over £25,000 must send annual reports and accounts to the Charity Commission. If inflation was low and adjustment after five years would see the threshold go up to only £25,500, it might be a sensible decision to keep the threshold at £25,000 until inflation would see an increase to, say, £30,000. We think that the sector as a whole would favour this discretionary approach over an automatic inflation adjustment.

3.16 Changes to thresholds that were not intended to reflect inflation (such as the recent increase in the audit threshold from £500,000 to £1 million)<sup>82</sup> would still be possible as a separate (though perhaps concurrent) exercise.

**Recommendation 1.**

3.17 We recommend that Government periodically review all financial thresholds in the Charities Act 2011 with a view to increasing them, by secondary legislation, in line with inflation.

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<sup>82</sup> See n 74.

# Chapter 4: Changing purposes and amending governing documents

## INTRODUCTION

4.1 Part 2 of the Consultation Paper, and Chapter 2 of the Supplementary Consultation Paper, examined the ways in which charities can change their purposes and amend their governing documents. With the passage of time, new needs will arise and unforeseen eventualities will occur, requiring charities to amend their governing documents to ensure their continuing effectiveness; we give some examples in Figure 1. The Charity Commission encourages charity trustees to keep their governing documents under review and consider whether they need to be amended.<sup>83</sup> Consultation responses revealed general agreement as to the importance of ensuring that changes can be made as quickly and efficiently as possible, whilst retaining safeguards to ensure that proposed amendments are appropriate.

### **Figure 1: examples of circumstances in which a charity may need to amend its governing document**

(1) To change the administrative procedures of the charity.

A charity may wish to change the process by which its trustees are appointed or by which members are admitted. Or a charity may prefer to communicate with its members and arrange general meetings by email to avoid the time and expense involved with postal communications, and may need to amend a provision in its governing document – for example, requiring first class post – in order to do so.

(2) To expand or limit the charity trustees' powers.

A charity's governing document may need to be amended to permit the trustees to borrow money, to purchase or lease property, or to employ staff. Conversely, an amendment may be made to restrict the trustees' powers, such as the default investment power under section 3 of the Trustee Act 2000.

(3) To update the governing document following legislative changes.

For example, a charity's governing document may need to be amended to reflect changes in equality or employment law.

(4) To remove anachronistic or offensively worded provisions.

Historic governing documents may contain provisions that are now out of date or are offensive.

<sup>83</sup> Charity Commission, *Changing your Charity's Governing Document* (CC36) (August 2011) para C1, available at <https://www.gov.uk/government/publications/changing-your-charitys-governing-document-cc36>.

(5) To change the charity's name.

Similarly to the provisions of a governing document, a charity's name may use words that have become out of date or are now offensive, or no longer accurately reflect its purposes.

(6) To change the charity's purposes.

The Charity Commission gives various examples of circumstances in which a charity may wish to change its purposes.<sup>84</sup> For example, the purposes of a charity established to care for people with disabilities may require the charity to provide institutions in which beneficiaries can be housed. The trustees may consider that its purposes should be amended so the charity can provide support for beneficiaries living in their own homes.

4.2 The ability of charities to change their purposes, and amend other provisions in their governing documents, depends on their legal form. We explained the current law in detail in Chapter 3 of the Consultation Paper; we present a summary here.

4.3 We start by considering the most common forms of corporate charities (charitable companies and CIOs) before turning to unincorporated charities (trusts and unincorporated associations). At the end of this chapter is a table summarising the effect of our proposed reforms. In Chapter 5, we look at charities that are incorporated by (or governed by) legislation or by Royal Charter.

## CHARITABLE COMPANIES AND CIOs

### The current law

4.4 The articles of association of a company (whether or not it is charitable) and the constitution of a CIO can generally be amended by a resolution of its members at a general meeting.<sup>85</sup> Companies' articles and CIOs' constitutions may, however, provide for more restrictive conditions to be satisfied before they can be amended (for example, obtaining the consent of a particular person or the Charity Commission), known as "entrenchment", but such provision cannot prevent amendment with the unanimous agreement of the charity's members.<sup>86</sup>

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<sup>84</sup> Charity Commission, *OG2 Application of property cy-près* (March 2012) para A1, available at <http://ogs.charitycommission.gov.uk/g002a001.aspx>.

<sup>85</sup> Companies Act 2006, s 21 (charitable companies), Charities Act 2011, s 224 (CIOs). A resolution must be passed by at least 75% of the members voting or, in the case of a resolution of the members of a CIO otherwise than at a general meeting, by unanimous agreement of the members: Companies Act 2006, s 283; Charities Act 2011, s 224(2).

<sup>86</sup> Companies Act 2006, s 22; Charitable Incorporated Organisations (General) Regulations 2012 SI 2012 No 3012, reg 15(3). We refer to the Regulations as the "2012 Regulations".

- 4.5 If the amendment that a charitable company or CIO wishes to make is a “regulated alteration”, then it must obtain the Charity Commission’s prior consent to the change.<sup>87</sup> A “regulated alteration” is:
- (1) an amendment to the charity’s purposes;
  - (2) an alteration to the provisions concerning the distribution of the charity’s property in the event of dissolution; or
  - (3) any alteration that would authorise a benefit to be obtained by the charity’s directors or members (or connected persons), unless that benefit is authorised by section 185 of the Charities Act 2011.<sup>88</sup>
- 4.6 We discuss the basis on which the Charity Commission will consent to a change of purposes in paragraphs 4.123 and following.
- 4.7 Charitable companies must take the following steps after a resolution has been passed to amend its articles.
- (1) The company must give notice of the amendment to the Registrar of Companies and provide a copy of the articles as amended, the resolution giving effect to the amendment, and (in the case of a regulated alteration) a copy of the Charity Commission’s consent, all within 15 days of the resolution taking effect.<sup>89</sup> Where the amendment is to the charity’s purposes, the amendment is not effective until it is recorded on the register at Companies House.<sup>90</sup> A failure to notify Companies House of other amendments can lead to criminal liability on the part of the company and its directors, but does not prevent the amendment from being effective.<sup>91</sup>
  - (2) If the charitable company is registered with the Charity Commission, the trustees must also notify the Commission of the amendment so that the particulars of the charity in the register can be updated.<sup>92</sup>
- 4.8 The procedure for CIOs is in some ways simpler but also more restrictive. Once a resolution has been passed, the CIO must send a copy of the constitution as amended and the members’ resolution to the Charity Commission.<sup>93</sup> An amendment takes effect

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<sup>87</sup> Charities Act 2011, ss 198(1), 226, 248 and 249. In addition, a CIO cannot amend its constitution in such a way that would result in it ceasing to be a charity: Charities Act 2011, s 225.

<sup>88</sup> Charities Act 2011, ss 198(2) and 226(2). The meaning of “benefit” is set out in ss 199 and 248 and of “connected person” in ss 200 and 249. Authorised benefits under s 185 are considered in Ch 9.

<sup>89</sup> Companies Act 2006, ss 26(1) and 30(1), and Charities Act 2011, s 198(3).

<sup>90</sup> Companies Act 2006, s 31(2)(c).

<sup>91</sup> Companies Act 2006, ss 26(3), 27 and 30(2); Charities Act 2011, s 198(5).

<sup>92</sup> Charities Act 2011, s 35(3). The procedure is explained in more detail in Charity Commission, *Changing your Charity’s Governing Document* (CC36) (August 2011), paras 3.6 and 3.7; and *OG518 Alterations to Governing Documents: Charitable Companies* (May 2015), para B, available at <http://ogs.charitycommission.gov.uk/g518a001.aspx>.

<sup>93</sup> Charities Act 2011, s 227(1).



once it is registered by the Charity Commission, and the Commission will refuse to register an amendment in certain circumstances.<sup>94</sup>

### **The general framework**

4.9 Our provisional view was that the regime governing changes by companies and CIOs was satisfactory.<sup>95</sup> Broadly speaking, the rules were supported by consultees. Such charities were considered to have sufficient flexibility to make most changes without having to obtain the Charity Commission's consent (subject to express entrenchment and provided they are not "regulated alterations"). It was generally considered appropriate that the Charity Commission should have oversight of changes that were regulated alterations, and no consultee suggested that the definition should be significantly expanded or narrowed. Nevertheless, some technical deficiencies were raised by consultees which we now turn to consider.

### **Differences between companies and CIOs**

4.10 CIOs were introduced by the Charities Act 2006 as an alternative to the charitable company; they are incorporated bodies, and the charity trustees and members benefit from limited liability, but the Registrar of Companies is not involved in their registration or regulation. There should, so far as possible, be consistency between the rules governing charitable companies and CIOs. Various inconsistencies were raised by consultees.<sup>96</sup> Some are justifiable, and some extend beyond our terms of reference.<sup>97</sup> We do, however, make a recommendation in respect of one inconsistency raised by consultees.

4.11 Constitutional amendments for CIOs do not take effect until they are registered by the Charity Commission<sup>98</sup> whereas this limitation only applies to companies if the amendment changes its objects.<sup>99</sup> Having to wait until registration for amendments to take effect was said to be unhelpful, unduly limiting and confusing, particularly as there is no process for CIOs to be notified of the exact date on which changes were registered.<sup>100</sup> We can see the potential benefits of the increased Charity Commission oversight of constitutional amendments by CIOs under the current law. The grounds on which the Charity Commission can refuse to register an amendment might ensure that defective or invalid amendments are spotted at an early stage, and before charities purport to rely on them, which might create consequential problems. We also note that CIOs are a new structure – it has only been possible to create CIOs since January 2013<sup>101</sup> – and they are still therefore "bedding in".

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<sup>94</sup> Charities Act 2011, s 227(2), (3) and (4).

<sup>95</sup> Consultation Paper, paras 5.20 and 6.2.

<sup>96</sup> The CLA; Bircham Dyson Bell LLP; Prof Gareth Morgan.

<sup>97</sup> See Analysis of Responses, Ch 6.

<sup>98</sup> Charities Act 2011, s 227(2).

<sup>99</sup> In which case, the amendment only takes effect when it is registered by the Registrar of Companies: Companies Act 2006, s 31(2)(c).

<sup>100</sup> Bircham Dyson Bell LLP and Prof Gareth Morgan.

<sup>101</sup> When the 2012 Regulations came in to force.

- 4.12 However, having discussed this issue further with consultees we think that the arguments in favour of aligning the position for CIOs with that for charitable companies outweigh the arguments in favour of greater oversight. First, when possible, consistency between the two regimes is desirable. Greater alignment leaves less room for confusion between the two and therefore less scope for error; it would avoid potential problems arising from trustees of CIOs thinking that, as for companies, amendments take effect from the date of the resolution. Second, we heard from consultees that an important benefit of amendments taking effect immediately (or on a later date specified in the resolution) is that constitutional change can be planned and implemented in an orderly way. It can, for example, coincide with a year-end date or other significant event, such as a change of control of the charity. Allowing amendments to CIO constitutions to take effect from the date of the resolution (or a later date specified in the resolution) will remove barriers to, and complications arising during, constitutional change.
- 4.13 We recommend that amendments to a CIO's constitution should take effect when the resolution containing them is passed, or on a later date specified in the resolution. If the amendment is a "regulated alteration", the prior written consent of the Charity Commission would still be required; if such consent has not been obtained, the amendment will be ineffective. An amendment changing a CIO's purposes will both (1) need prior consent from the Charity Commission (as it is a regulated alteration); and (2) not take effect until registered by the Charity Commission. CIOs would still be required to send a copy of any resolution amending their constitution to the Charity Commission within 15 days of it being passed.

#### **Definition of regulated alterations**

- 4.14 Three consultees<sup>102</sup> raised various difficulties with the three categories of "regulated alterations" in section 198 (for companies) and section 226 (for CIOs) of the Charities Act 2011.

(1) The first category: changes to objects

- 4.15 Section 198(2)(a) refers to amendments "adding, removing or altering a statement of the company's objects" whereas section 226(2)(a) refers to amendments which would make "any alteration of the CIO's purposes". By contrast, the second and third categories of regulated alterations use the same wording. We think that it would be desirable for the definition of "regulated alterations", so far as possible, to be the same for both companies and CIOs and we recommend a new definition below.

- 4.16 Consultees also commented that section 198 appeared to include (or reported experiences of it being interpreted as including):

- (1) an alteration to the wording of the charity's objects even if the substance of those purposes remains the same; and
- (2) any change to the powers of a charity referred to in the objects cause, even if the objects themselves were not being changed.

- 4.17 We agree that such amendments should not be regulated alterations. It was also suggested that an amendment to a governing document which would have the effect of

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<sup>102</sup> The CLA; Bircham Dyson Bell LLP; and Francesca Quint. See Analysis of Responses, Ch 5.

altering the charity's purposes without altering the wording of the objects clause itself might not fall within the current definition. An example was given of an amendment to a defined term, when that term appeared in the objects clause. Charity Commission guidance, however, suggests that such an amendment does fall within the current definition.<sup>103</sup> We agree, and our recommendation would ensure that the substance and not form of the amendment will determine whether or not an amendment is a regulated alteration, thus removing any potential confusion.<sup>104</sup>

(2) The second category: dissolution

4.18 Section 198(2)(b) provides that an amendment to a provision "directing the application of property of the company on dissolution" is a regulated alteration.<sup>105</sup> There was reported to be uncertainty as to whether an amendment that has the effect of overriding a dissolution clause is caught by this definition. The CLA gave the example of the introduction of a power to merge which allows the charity to merge with another rather than dissolve, and therefore the direction in the articles as to what happens to the company's property on dissolution does not take effect.

4.19 In our view, the purpose of the second category of regulated alteration is to ensure that property belonging to a charitable company is applied for exclusively charitable purposes on dissolution. It is not intended to prevent the charity from making an amendment that would avert the need for it to dissolve or to protect – say – the right of a third party charity named in a dissolution clause to receive the company's property on dissolution. The CLA and Bircham Dyson Bell LLP explained that such third party rights could be secured in better ways. Our view is therefore that section 198(2)(b) only applies to an amendment of a company's dissolution clause, and that other amendments that have the effect of avoiding the need to dissolve are not regulated alterations.

(3) The third category: benefits to trustees, members and connected persons

4.20 Sections 198(2)(c) and 226(2)(c) provide that any alteration that would "provide authorisation for any benefit to be obtained by" the charity's trustees or members, or connected persons, is a regulated alteration. Consultees suggested that it is unclear whether that definition would include an amendment that *narrows* the circumstances in which benefits can be authorised; the amendment itself does not authorise benefits to be obtained, but the clause as amended does authorise benefits to be obtained. In our view, such an amendment would not be a regulated alteration under the current law. An alteration is only regulated under these provisions if it is the *alteration* itself which would provide the authorisation for benefits. So if a benefit is already permitted and all an

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<sup>103</sup> See *OG518 Alterations to Governing Documents: Charitable Companies* (May 2015), para B2.2.

<sup>104</sup> We are aware that our proposed reform would create a slight difference between (1) the requirement to seek Charity Commission consent to an amendment under the reformed Charities Act, s 198(3), and (2) the requirement to register an amendment with Companies House under the Companies Act 2006, s 31(2). The former will be slightly narrower, only requiring a company to seek Charity Commission consent where there is in fact a substantive change to its charitable purposes, whereas the latter will require registration of any amendment to the company's statement of objects. We think that this divergence is justified on the basis that Companies House is interested in registering any change to the statement of a company's objects, whereas the Charity Commission is only interested in overseeing those changes which affect – in substance – the company's charitable purposes.

<sup>105</sup> Charities Act 2011, s 226(2)(b) makes equivalent provision for CIOs.

alteration does is reduce the extent of if, the alteration is not authorising a benefit and is therefore not regulated.

### Schemes in respect of charitable companies and CIOs

4.21 In the Consultation Paper, we noted that cases in which the statutory powers of amendment could not be used to change the governing document of a company or CIO would be rare, but that in such cases a scheme could be made to amend the governing document.<sup>106</sup> Schemes are legal arrangements, made by the Charity Commission or the court, that change or supplement the provisions that would otherwise apply in respect of a charity or a gift to charity. We discuss schemes in more detail in paragraph 4.37 below.

4.22 Two consultees said that there was uncertainty as to whether the scheme-making power applied in the case of companies and other corporate charities.<sup>107</sup> We accept that the scheme-making power of the court originally depended on the existence of a trust, whereas a charitable company generally holds its property beneficially. But a scheme was made in *Liverpool and District Hospital for Diseases of the Heart v Attorney General*<sup>108</sup> despite the absence of a trust, and we see no reason to exclude corporate charities from the scheme-making power of the court and Charity Commission.<sup>109</sup>

#### Recommendation 2.

4.23 We recommend that:

- (1) an amendment to a CIO's constitution by resolution of its members should take effect on the date the resolution is passed, or on a later date specified in the resolution; save that
  - (a) an amendment that makes a regulated alteration should be ineffective unless the prior consent of the Charity Commission has been obtained; and
  - (b) a change of a CIO's purposes should not take effect until it has been registered by the Charity Commission;
- (2) the description of changes to a charity's objects as a "regulated alteration" in section 198(2)(a) be amended to reflect the description in section 226(2)(a); and
- (3) the Charities Act 2011 be amended to provide that the court and Charity Commission's power to make schemes in respect of charities extends to corporate charities.

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<sup>106</sup> Consultation Paper, para 3.8.

<sup>107</sup> William Henderson and Francesca Quint. See Analysis of Responses, ch 5, and *Tudor on Charities* (10th ed 2015), paras 10-130 to 10-135.

<sup>108</sup> [1981] Ch 193.

<sup>109</sup> We consider the scheme-making powers in respect of statutory and Royal Charter charities in Ch 5.

4.24 Clauses 1, 2 and 8 of the draft Bill would give effect to this recommendation.

4.25 We make a further recommendation below concerning the basis on which the Charity Commission should consent to a charitable company or CIO changing its purposes.

## UNINCORPORATED CHARITIES

### The current law

4.26 The trust deeds of charitable trusts, and the constitutions of unincorporated associations, can be amended in one of four ways.

#### (1) Express power

4.27 Trust deeds and the constitutions of unincorporated associations often include express powers of amendment.<sup>110</sup> Such powers might require particular conditions to be satisfied, such as obtaining the consent of the Charity Commission or another person, or securing a resolution of a particular majority of the charity's trustees or members at a general meeting.

#### (2) Statutory power to change a small unincorporated charity's purposes

4.28 Under section 275 of the Charities Act 2011, the purposes of certain small unincorporated charities can be changed by a resolution of the charity trustees.<sup>111</sup> The power applies to unincorporated charities that both (a) have an annual income of up to £10,000 and (b) do not hold "designated land", namely land held on trusts stipulating that it must be used for the purposes of the charity.<sup>112</sup> The power applies whether or not the governing document contains an express power of amendment; charities with an express power can choose instead to exercise the statutory power.

4.29 To exercise the power, the charity trustees must be satisfied (1) that it is expedient in the interests of the charity for the purposes in question to be replaced, and (2) that, so far as is reasonably practicable, the new purposes consist of or include purposes that are similar in character to those that are to be replaced.<sup>113</sup>

4.30 A copy of the resolution, together with the trustees' reasons for passing it, must be given to the Charity Commission.<sup>114</sup> The Commission can require the trustees to provide further information, or to publicise the resolution.<sup>115</sup> Otherwise, the resolution will take

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<sup>110</sup> See, for example, cl 31 of the Charity Commission's model trust deed and cl 7 of the Charity Commission's model constitution for a charitable unincorporated association: see n 48 above. Historic schemes often include express amendment powers.

<sup>111</sup> Charities Act 2011, s 275(2). The resolution must be passed by at least two-thirds of the charity trustees who vote on it: Charities Act 2011, s 275(5). Unlike the power to amend administrative provisions in s 280 (see paras 4.32 and following), there is no requirement for the charity's members (if separate from the trustees) to approve the resolution.

<sup>112</sup> Charities Act 2011, s 275(1). For example, a village hall may be held as "designated land".

<sup>113</sup> Charities Act 2011, s 275(4).

<sup>114</sup> Charities Act 2011, s 275(6).

<sup>115</sup> Charities Act 2011, s 276(1) and (2).

effect 60 days after it is received by the Commission,<sup>116</sup> unless the Commission objects to the resolution.<sup>117</sup>

4.31 A charity with an income of over £10,000 or which has designated land, and whose governing document does not contain an express power of amendment, can only change its objects by obtaining a scheme from the Charity Commission (on which see below).

(3) Statutory power to amend administrative provisions in an unincorporated charity's governing document

4.32 Under section 280 of the Charities Act 2011, the charity trustees of an unincorporated charity (regardless of its size or of whether it holds designated land) may pass a resolution to modify any provision in its governing document:

- (a) relating to any of the powers exercisable by the charity trustees in the administration of the charity, or
- (b) regulating the procedure to be followed in any respect in connection with its administration.<sup>118</sup>

4.33 Similarly to section 275, the power applies whether or not the governing document contains an express power of amendment; charities with an express power can choose instead to exercise the statutory power.

4.34 If the charity is an unincorporated association with a body of members distinct from the charity trustees, the amendment must be approved by at least two thirds of the members at a general meeting.<sup>119</sup>

4.35 The Charity Commission's guidance includes various examples of changes that it considers can be made using this statutory provision; see Figure 2.

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<sup>116</sup> Charities Act 2011, s 277. If the Commission requires the trustees to provide further information or publicise the resolution, the 60-day period is suspended until those requests have been complied with: s 278(4) and (5). If the 60-day period of time is suspended for more than 120 days, the resolution is automatically annulled: s 278(6) and (7).

<sup>117</sup> Charities Act 2011, s 278.

<sup>118</sup> This power originally applied only to small charities (with an income of £5,000 or less) that did not hold designated land: Charities Act 1993, s 74. It was amended by the Charities Act 2006, s 42, to apply to all unincorporated charities, regardless of size and regardless of whether they held designated land.

<sup>119</sup> Charities Act 2011, s 280(3) and (4).

## Figure 2: amendments that can be made under section 280

The Charity Commission's view is that section 280 permits charities to make changes to (amongst other things):

- the charity's name;
- the method of appointing trustees;
- the number of trustee meetings each year;
- the method of appointing the chair;
- the quorum provisions;
- the criteria for charity membership; and
- powers of a third party to appoint trustees (where that third party has ceased to exist or consented to the change).<sup>120</sup>

4.36 If a proposed change does not fall within the two categories of provisions in section 280 of the Charities Act 2011, and if the governing document does not contain an express power of amendment, the charity must seek a scheme from the Charity Commission to amend provisions in the charity's governing document (on which see below).

### (4) Cy-près or administrative scheme

4.37 If an unincorporated charity wishes to amend its governing document but the powers outlined above are not available, then it can apply to the Charity Commission for a scheme to make the amendment sought.<sup>121</sup> As explained in paragraph 4.21 above, schemes are legal arrangements that change or supplement the provisions that would otherwise apply in respect of a charity or a gift to charity. There are two categories of scheme.

- (1) "Cy-près schemes" alter the purposes of a charity. "Cy-près" means "as near as possible" or "near to this", and involves funds being applied for charitable purposes which are similar to the original purposes.
- (2) "Administrative schemes" alter any other provisions of a charity's governing document.

4.38 Cy-près schemes can be subdivided into those that deal with "initial failure" of a charitable purpose, and those that address "subsequent failure". Initial failure tends to

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<sup>120</sup> Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2017) paras B5.3 to 5.4 and E5.1, available at <http://ogs.charitycommission.gov.uk/g519a001.aspx>.

<sup>121</sup> We explain the scheme-making powers of the court and the Charity Commission in the Consultation Paper, paras 3.20 to 3.39. In practice, most schemes are now made by the Charity Commission.

arise in the administration of wills, for example, where a testator has left insufficient funds to carry out the stated charitable purpose. Subsequent failure tends to concern the work of existing charities, for example, a charity's original purpose is to provide accommodation for people with disabilities, but its beneficiaries would be best served by supporting them in their own homes.<sup>122</sup>

4.39 In the case of initial failure, a cy-près scheme can only be made if the donor has demonstrated a "general charitable intention".<sup>123</sup> The same does not apply to subsequent failure; if the gift was given outright to a charity, then a cy-près scheme can be made on subsequent failure without having to demonstrate an initial general charitable intention on the part of the donor.

4.40 The power to make administrative schemes is wide; it can be exercised if it is expedient in the interest of the charity to do so.<sup>124</sup> By contrast, cy-près schemes are closely regulated; there are limitations on both the circumstances in which a cy-près scheme can be made and the changes that can be made by a cy-près scheme. Both are explained below.

*How does the Charity Commission decide whether to make a cy-près scheme?*

4.41 There are limitations on (A) the circumstances in which a cy-près scheme can be made; and (B) the changes that can be made by a cy-près scheme. Both are explained below.

*(A) Cy-près schemes: the gateways*

4.42 The circumstances in which the Charity Commission can make a cy-près scheme (known as the "cy-près occasions") are set out in section 62 of the Charities Act 2011: see Figure 3. We refer to them as "the section 62 cy-près occasions".

**Figure 3: the section 62 cy-près occasions – gateways to a cy-près scheme**

Property may be applied cy-près in any of the following situations:

- (1) where the original purposes, in whole or in part, have been fulfilled;<sup>125</sup>
- (2) where the original purposes, in whole or in part, cannot be carried out (or not according to the directions given and to the spirit of the gift);<sup>126</sup>

<sup>122</sup> See Consultation Paper, paras 3.25 to 3.27 and *Tudor on Charities* (10th ed 2015), para 9-018.

<sup>123</sup> *Tudor on Charities* (10th ed 2015), paras 9-004 and 9-008. Whether a donor had a general charitable intention is a matter of construction of the gift. We discuss the meaning of a general charitable intention in the Consultation Paper, paras 3.30 to 3.32. It is also discussed in *Tudor on Charities*, paras 9-018 to 9-035 where the authors conclude that it distinguishes "between cases where the particular directions which are impracticable form an essential part of the donor's charitable intention and those where they do not".

<sup>124</sup> *Re J W Laing Trust* [1984] Ch 143.

<sup>125</sup> Charities Act 2011, s 62(1)(a)(i). For example, a charity for the redemption of slaves in Turkey, as in *Attorney General v Ironmongers' Co* [1834] 39 ER 1064.

<sup>126</sup> Charities Act 2011, s 62(1)(a)(ii). For example, *Attorney General v Glyn* [1841] ER 1062 concerned a school for the education of poor children within a certain district; the district had been converted into a dock under a local Act and there were no children to attend the school, so a cy-près scheme was made.



- (3) where the original purposes provide a use for only part of the property;<sup>127</sup>
- (4) where (i) the property, and (ii) other property applicable for similar purposes, can be more effectively used together and, regard being had to the “appropriate considerations”, can suitably be used for common purposes.<sup>128</sup> The “appropriate considerations” are:
  - (a) (on the one hand) the spirit of the gift concerned; and
  - (b) (on the other) the social and economic circumstances prevailing at the time of the proposed alteration of the original purposes;<sup>129</sup>
- (5) where the original purposes were laid down by reference to an area that has ceased to be readily identifiable;<sup>130</sup>
- (6) where the original purposes were laid down by reference to a class of persons or an area which has ceased to be suitable, regard being had to the appropriate considerations (see above), or to be practical in administering the gift;<sup>131</sup>
- (7) where the original purposes, in whole or in part, have been adequately provided for by other means;<sup>132</sup>
- (8) where the original purposes, in whole or in part, have ceased to be charitable;<sup>133</sup> and
- (9) where the original purposes, in whole or in part, have ceased in any other way to provide a suitable and effective method of using the property, regard being had to the appropriate considerations (see above).<sup>134</sup>

<sup>127</sup> Charities Act 2011, s 62(1)(b). This restated the jurisdiction to make cy-près schemes in respect of surplus funds.

<sup>128</sup> Charities Act 2011, s 62(1)(c). A scheme might be made to combine the operations of various small charities working in one area. We discuss the merger of charities in Ch 11.

<sup>129</sup> Charities Act 2011, s 62(2). Before the Charities Act 2006, the only consideration was “the spirit of the gift”. The Charities Act 2006, s 15, amended the Charities Act 1993, s 13, to include the opposing consideration, the social and economic circumstances.

<sup>130</sup> Charities Act 2011, s 62(1)(d)(i). For example, where an area is difficult to identify owing to local government area boundary changes: H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 456.

<sup>131</sup> Charities Act 2011, s 62(1)(d)(ii). This replaces the strict common law requirement of impossible or impracticable with “unsuitable”. As well as these circumstances, a scheme can be made enlarging a charity’s area of benefit by reference to the table in Charities Act 2011, sch 4: Charities Act 2011, s 62(5). For example, if the area of benefit is a district, it can be enlarged to “any area which includes the district”: sch 4, para 3. See also Charity Commission, *OG2 Application of property cy-près* (March 2012) para A1.1.2.

<sup>132</sup> Charities Act 2011, s 62(1)(e)(i). This provision is used when a charity’s purposes become the statutory responsibility of a public authority, such as the maintenance of a road or bridge.

<sup>133</sup> Charities Act 2011, s 62(1)(e)(ii).

<sup>134</sup> Charities Act 2011, s 62(1)(e)(iii). This was a significant relaxation of the common law requirements for cy-près: *Tudor on Charities* (10th ed 2015), para 10-062. This power was used in *Varsani v Jesani* [1999] Ch 219 where, following a schism within a religious sect, the charity’s funds were divided between the two rival factions.

- 4.43 In the absence of a section 62 cy-près occasion, the Charity Commission cannot make a cy-près scheme to change a charity's purposes.
- 4.44 Some consultees thought the cy-près occasions were too restrictive. Bircham Dyson Bell LLP said the cy-près occasions require trustees "to wait until the situation has become almost unrescuable" so they "do not encourage trustees to think ahead and plan to make their charity more effective before such a situation arises".<sup>135</sup>

*(B) Cy-près schemes: permitted changes*

- 4.45 If a section 62 cy-près occasion has arisen, the Charity Commission can make a cy-près scheme. Section 67 of the Charities Act 2011 requires the Commission to have regard to certain matters, which we refer to as "the section 67 similarity considerations": see Figure 4.

**Figure 4: the section 67 similarity considerations**

The court or Commission can make a cy-près scheme applying property for such charitable purposes as it considers appropriate, having regard to:

- (1) the spirit of the original gift;<sup>136</sup>
- (2) the desirability of securing that the property is applied for charitable purposes which are close to the original purposes; and
- (3) the need for the relevant charity to have purposes which are suitable and effective in the light of current social and economic circumstances.

- 4.46 The Charity Commission summarises its policy on exercising its discretion under section 67 as follows:

We should be flexible and imaginative in applying the cy-près doctrine, balancing usefulness and practicality with respect for the existing purposes and beneficiaries. The purpose of making a cy-près scheme is to enable a charity to continue being effective, useful and relevant to its beneficiaries' needs in modern society, where without our intervention it would not be. We should, however, exercise caution where a proposed change might be a significant departure from the founder's intentions or might exclude existing beneficiaries (unless, for example, the problem is that the existing beneficial class has ceased to exist). We should always take account of the trustees' views when deciding how to amend a charity's objects.<sup>137</sup>

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<sup>135</sup> Bircham Dyson Bell gave the example of a school for the education of boys wishing to change its purposes to include the education of girls. To fall within the cy-près occasions, the trustees arguably have to wait until they can no longer run the school for boys, by which point the school will have been put in jeopardy. In practice, trustees have to rely on the Charity Commission to support a "creative interpretation" of s 62.

<sup>136</sup> See *Re Lepton's Charity* [1972] Ch 276 on the meaning of "the spirit of the gift".

<sup>137</sup> Charity Commission, *OG2 Application of property cy-près* (March 2012), para 3.2.

## Publicising schemes

- 4.47 The Charity Commission must give public notice of a proposed scheme where it appoints, discharges or removes a trustee. In all other cases, public notice must be given unless the Charity Commission considers it unnecessary.<sup>138</sup> The decision whether to give public notice will depend on whether the change is controversial. The Commission will usually expect the trustees to carry out their own consultation, which will assist the Commission in deciding whether the scheme is controversial and therefore whether public notice is required.<sup>139</sup>
- 4.48 The Charity Commission's guidance says that publicity will almost always be required where the scheme will "change the use of community assets, give a power to dispose of designated property or involve the displacement of beneficiaries" since such schemes are often contentious.<sup>140</sup> Otherwise, the need for publicity will be considered on a case-by-case basis and the following factors might lead the Commission to decide that notice is required:
- (1) where there is a significant level of public interest in the aspects of the charity that the scheme will affect;
  - (2) where the scheme will materially affect designated property but not to the extent that it can be sold, for example, where the scheme will substantially change the purposes for which the property can be used;
  - (3) where the scheme will materially affect the objects of the charity; and
  - (4) where the Commission is aware of opposition to the proposed scheme which has not been addressed by the trustees' consultation.

## The Consultation Paper

- 4.49 In the Consultation Paper, we noted the difference between the amendment regimes for corporate charities (companies and CIOs) and unincorporated charities (trusts and unincorporated associations). We said it was arguable that the two regimes should be aligned. But we thought that aligning the amendment powers for existing charities could be unsatisfactory on the basis that "governing documents are drafted against the backdrop of the legal rules that exist at the time of drafting" and "it is possible that a particular legal structure has been chosen for the strict (or relaxed) rules concerning amendment that it entails".<sup>141</sup> We were not attracted to creating a dual regime, one for existing charities and one for future charities. As a result, despite acknowledging the argument for alignment in principle we reached a provisional view that the different amendment regimes for existing corporate and unincorporated charities should not be

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<sup>138</sup> Charities Act 2011, ss 88 and 89.

<sup>139</sup> Charity Commission, *Charity Commission, Changing your Charity's Governing Document (CC36) (August 2011)*, para 4.4; *OG500 Schemes* (January 2017) paras B10 and E6.1, available at <http://ogs.charitycommission.gov.uk/g500a001.aspx>.

<sup>140</sup> Charity Commission, *OG500 Schemes* (January 2017), para B10.5.

<sup>141</sup> Consultation Paper, para 5.14.

aligned. We nevertheless invited consultees' views about alignment for charities established in the future.<sup>142</sup>

4.50 As an alternative to alignment, we proposed that the section 275 power<sup>143</sup> be extended to charities with a larger income and invited views as to the appropriate income threshold. We also proposed that the exclusion of charities with designated land from section 275 be removed.<sup>144</sup>

4.51 We commented that the scope of the section 280 power<sup>145</sup> was uncertain, and that it was potentially too wide in some respects and too narrow in others. We invited consultees' views as to whether the power was helpful and sufficiently clear and as to the types of provision that should fall within, and outside, the power.<sup>146</sup>

## Consultation responses

### Alignment with the regime for companies and CIOs

4.52 Despite our hesitation about aligning the regimes for corporate and unincorporated charities, the majority of consultees who addressed the issue expressed firm views that the amendment powers of unincorporated charities should, as far as possible, be aligned with the amendment powers of corporate charities. Consultees said that alignment would create consistency between charities and simplify the law. Some thought that an aligned amendment regime should apply to both existing and future charities. Historically, there have been numerous changes to the regime governing existing charities<sup>147</sup> and our provisional view that the regime should not be changed for existing charities "would suggest that charity law could never change but be crystallised around a trust as at the time it was created".<sup>148</sup> Some consultees cast doubt on our suggestion that a particular legal structure is chosen deliberately for the more restrictive amendment rules that apply.<sup>149</sup> Moreover, unincorporated charities could potentially transfer to the regime for corporate charities – albeit at an administrative cost – by incorporating; they can wind up and transfer their assets and operations to a new charitable company established for the purpose of carrying on the charity's work.<sup>150</sup>

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<sup>142</sup> Consultation Paper, paras 5.13 to 5.19.

<sup>143</sup> For unincorporated charities to change their objects; see paras 4.28 to 4.31.

<sup>144</sup> Consultation Paper, paras 5.32 to 5.34.

<sup>145</sup> For unincorporated charities to amend administrative provisions in their governing documents; see paras 4.32 to 4.36.

<sup>146</sup> Consultation Paper, paras 6.5 to 6.16.

<sup>147</sup> For example, the introduction of the powers in Charities Act 2011, ss 104A, 275, 280, 281 and 282 and the expansion of the *cy-près* occasions in the Charities Acts 1960 and 2006, all of which changed the law as it applied to existing charities, including powers to amend governing documents.

<sup>148</sup> *Bircham Dyson Bell LLP*.

<sup>149</sup> See further para 4.64.

<sup>150</sup> However, the Charity Commission and Chancery Bar Association cautioned that this point should not be overstated. Not only can incorporation be a time consuming and costly process but incorporating solely for the purpose of avoiding the *cy-près* regime could amount to a fraud on the power.

4.53 The main counter-argument raised by consultees was that alignment would sweep away the law of cy-près, since changes to unincorporated charities' purposes would no longer be subject to the precondition that a section 62 cy-près occasion had arisen and the section 67 similarity considerations. These consultees appeared to base their view on:

- (1) the need for some limitation on charities changing their purposes;
- (2) the importance of respecting the wishes of donors and founders; it was thought that increased flexibility might risk damaging donors' willingness to set up charities if they know that the purposes they specify can be changed to something altogether different;
- (3) the cy-près regime providing a clear basis for the Charity Commission to make difficult decisions that must balance competing interests; and
- (4) familiarity with the current regime.

4.54 By contrast, some consultees thought that removing the law of cy-près was an attractive prospect since they considered the section 62 cy-près occasions to be unnecessarily restrictive, unclear and poorly understood.

4.55 This was an issue on which we sought further views in our Supplementary Consultation Paper.<sup>151</sup>

#### Changing purposes: cy-près schemes and section 275

4.56 The current law generally requires a change to a charity's purposes (regardless of the charity's legal form) to be overseen by the Charity Commission.<sup>152</sup> A clear majority of consultees thought that this should continue, whether the charity is large or small, and that the Charity Commission's power to make cy-près schemes should not be extended to charity trustees.<sup>153</sup> Action with Communities in Rural England noted that trustees are volunteers and "they do not generally have the skills to ensure this type of change would be undertaken correctly". Charity Commission oversight was seen as a means to ensure that a charity's purposes, as altered, remained charitable.<sup>154</sup>

4.57 Consultees who favoured alignment of the regimes for corporate and unincorporated charities expressed mixed views about the continuing role of section 275. Most thought

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<sup>151</sup> See paras 4.65 to 4.74 below.

<sup>152</sup> For companies and CIOs, a change of purposes is a regulated alteration requiring the consent of the Charity Commission (see para 4.5); for unincorporated charities, the Charity Commission is involved under the s 275 procedure and in making a cy-près scheme (albeit to differing extents). The exception is for unincorporated charities with an express amendment power; a change of purposes by such a charity does not require Charity Commission consent.

<sup>153</sup> The only dissent came from four consultees who thought the Charity Commission's power to object to a s 275 resolution should be removed and four consultees who thought that trustees should be given a power to make cy-près schemes.

<sup>154</sup> The Charity Commission of Northern Ireland; the Charity Commission; Bircham Dyson Bell LLP; the CLA; and the RSPCA.

that the power should be retained, and extended to corporate charities.<sup>155</sup> Others thought that section 275 could be repealed as it would be unnecessary.<sup>156</sup>

- 4.58 Whether or not consultees favoured an aligned regime, and assuming that section 275 is retained, most agreed with our proposal to expand its scope. There was, however, a concern that section 275 did not include a capital threshold and so was potentially available to large charities that were asset-rich despite being income-poor; that concern would be intensified by an increase in the income threshold or by extending the power to charities with designated land.<sup>157</sup> Some consultees suggested that section 275 should include an additional threshold based on the capital value of the charity's assets.
- 4.59 Most consultees agreed with our proposal that a section 275 resolution should only take effect if it has been agreed by a resolution of the charity's members (if any). However, some consultees raised concerns about the additional administrative expense this would involve for what is intended to be a quick, inexpensive and easy power for very small charities;<sup>158</sup> other concerns were raised about the inability of some charities to identify, let alone contact, all of their members.<sup>159</sup>

#### Changing administrative provisions under section 280

4.60 Consultees generally found section 280 to be a helpful power; it allows charities "to 'tidy up' out-of-date, ambiguous provisions"<sup>160</sup> and it can enable charities to make amendments "without undue administrative upheaval and expense".<sup>161</sup> But there was almost universal agreement that the scope of the power was unclear; it is "difficult to apply"<sup>162</sup> and the lack of clarity "may cause trustees to seek legal advice where they would otherwise be capable of using the power without advice".<sup>163</sup> Consultees gave various examples to demonstrate the uncertain scope of the power. The most common uncertainties were:

- (1) can the ability to "modify" powers permit charities to add altogether new powers?
- (2) can the rights and powers of third parties (such as founders) be overridden?
- (3) can section 280 be used where the governing document includes an express power of amendment which is subject to more onerous conditions?

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<sup>155</sup> Francesca Quint; Veale Wasbrough Vizards LLP; Fellowship of Independent Evangelical Churches; and Association of Church Accountants and Treasurers.

<sup>156</sup> The CLA, with whom Bircham Dyson Bell LLP agreed. Francesca Quint was also content with this option though her preference was to retain s 275.

<sup>157</sup> Since asset-rich, income-poor charities are often (though not always) those that hold designated land.

<sup>158</sup> Veale Wasbrough Vizards LLP and the Independent Schools Council disagreed with the proposal for a members' resolution for this reason. The CLA and Institute of Chartered Secretaries and Administrators raised the concern about costs, but nevertheless agreed with the proposal for a members' resolution.

<sup>159</sup> Independent Schools Council; Church Growth Trust; and Churches' Legislation Advisory Service.

<sup>160</sup> Anthony Collins Solicitors LLP.

<sup>161</sup> Bircham Dyson Bell LLP.

<sup>162</sup> Church Growth Trust.

<sup>163</sup> Veale Wasbrough Vizards LLP.

4.61 Consultees expressed a variety of views as to the provisions that should fall within, and outside, the power; many repeated their views that section 280 should permit any amendment save for “regulated alterations”, thereby aligning unincorporated charities with companies and CIOs.

### **Discussion and options for reform**

#### Reforming sections 275 and 280

4.62 We do not think that the expansion of the power in section 275 should be the driver of reform. Section 275 is, in effect, a mini-cy-près regime, carved out from the general law of cy-près; rather than focussing on the carve-out, we should focus on the general law. Nor do we think that adjusting or amending section 280 to clarify its scope is the appropriate starting point. Instead, we should look more fundamentally at charities’ ability to change their purposes and amend their governing documents and, as far as possible, apply a consistent regime that retains safeguards. An assessment of the continued role of section 275 should follow on from that.

#### Alignment

4.63 Following responses to the Consultation Paper and Supplementary Consultation Paper, we agree that the amendment regimes for corporate and unincorporated charities should, as far as possible, be aligned. As we go on to explain below, we recommend the creation of a new statutory amendment power that would seek to align the regimes.

Is it appropriate for a more relaxed regime to apply to unincorporated charities?

4.64 As we noted in the Consultation Paper, some founders might choose to establish a charity as a trust rather than a company in order to limit the circumstances in which changes (such as to the charity’s purposes) can be made, and they might deliberately omit express powers of amendment. Such founders might, therefore, object to any expansion of the section 62 cy-près occasions, or to their removal, because it would make future changes easier. But, as noted at paragraph 4.52 above, some consultees disputed the strength of this argument, pointing out that a charity’s legal structure is not necessarily a deliberate decision and the potential for charitable trusts to change form through incorporation. We do not therefore see closer alignment with companies – and an associated widening of the circumstances in which a charity’s purposes can be changed – as inappropriate.

### **The Supplementary Consultation Paper**

4.65 We saw the strengths of consultees’ arguments in favour of alignment. In the Supplementary Consultation Paper we expressed the view that the amendment regimes for corporate and unincorporated charities should, as far as possible, be aligned.

4.66 We were mindful of consultees’ concerns that alignment would sweep away the law of cy-près, which they considered would be a significant step since cy-près is an established part of charity law. We asked consultees for their views on the consequences of aligning the amendment powers in the case of a change of purposes and, in particular, what they thought should be the continuing role of the law of cy-près. We explained, however, that alignment need not bypass the whole law of cy-près. And even if it did, such a change was unlikely to be as radical in practice as it might at first

sight appear. When considering the concern, we said that it is important to distinguish between the two aspects of the law of cy-près, namely the section 62 cy-près occasions and the section 67 similarity considerations.

4.67 The position of corporate and unincorporated charities under the current law is summarised in the table below.

Change of purposes by a company/CIO	Change of purposes by a unincorporated charity (absent express power or section 275)
<p>Requires Charity Commission consent</p> <p>Charity Commission discretion, exercised in accordance with case law and other relevant legislation</p>	<p>Cy-près scheme can only be made if case falls within a section 62 cy-près occasion</p> <p>Section 67 similarity considerations will apply</p>

4.68 In devising a regime that seeks to align more closely the amendment powers of unincorporated charities with corporate charities, we said in our Supplementary Consultation that there are three possible approaches to a change of purposes. The effect of each on the law of cy-près is different.

Option (1): No alignment for change of purposes

4.69 It would be possible to align the amendment powers more closely whilst retaining the law of cy-près; unincorporated charities could be given the power to make any amendments save for a change of purposes, which would remain subject to amendment under the current law (namely, any express power, the section 275 power or a cy-près scheme). This would be the preferred option for those who oppose any relaxation of the circumstances in which unincorporated charities can change their purposes.

Option (2): Complete alignment of the regimes

4.70 Complete alignment with corporate charities would mean that neither the first nor second aspect of the law of cy-près would apply; unincorporated charities would be able to change their purposes without having to establish a section 62 cy-près occasion and there would be no section 67 similarity considerations in deciding the new purposes.

4.71 Whilst this approach would effectively bypass the law of cy-près, we set out the arguments in favour of its adoption.

- (1) As noted above, some consultees criticised the section 62 cy-près occasions, saying they were too restrictive.
- (2) Many unincorporated charities can, in effect, already change their purposes under the regime that applies to companies; they will often have express powers of amendment and when such powers require the charity to obtain the Charity Commission's consent to a change (such as the power in the Commission's



model governing documents),<sup>164</sup> the Commission will make its decision applying the same principles that it applies in deciding whether to consent to a change of purposes by a charitable company.

- (3) In any event, cy-près problems can be avoided by an unincorporated charity transferring to the regime for companies.<sup>165</sup>
- (4) An important safeguard continues to exist, even in the absence of the section 62 cy-près occasions: any decision to change a charity's purposes would always be taken by the charity trustees in accordance with their general duty to act in the best interests of the charity.

#### Option (3): A middle ground

4.72 We said that alignment need not necessarily bypass the law of cy-près. It would be possible to retain the section 67 similarity considerations (and, as we discuss below, extend them to companies and CIOs); they ensure that similarity between old and new purposes is an important factor in deciding a charity's new purposes, thereby protecting the wishes of founders and donors. An approach to alignment that retains the section 67 similarity considerations, but not the section 62 cy-près occasions, would not bypass the entire law of cy-près.

4.73 We noted that consultees' criticisms of the law of cy-près were aimed at the section 62 cy-près occasions, not at the section 67 similarity considerations. Conversely, consultees who were concerned about effectively abolishing the law of cy-près tended to be concerned about the purposes of a charitable trust being changed to something altogether different (that is, a loss of the section 67 similarity considerations), not about removal of the section 62 cy-près occasions.

4.74 As part of devising a new, aligned, power of amendment for unincorporated charities, in the Supplementary Consultation Paper we proposed that the trustees of an unincorporated charity should have a power, with the consent of the Charity Commission, to change the charity's purposes without having to establish a section 62 cy-près occasion. We said that the section 67 similarity considerations should continue to apply when the Charity Commission decides whether or not to give its consent to an unincorporated charity changing its purposes under a new, aligned, amendment power. As we go on to discuss, the majority of consultees agreed with us, and it is on that basis that we proceed to recommend the creation of a new amendment power.

#### **A new amendment power for unincorporated charities**

4.75 The vast majority of consultees supported a new statutory amendment power for unincorporated charities along the lines that we proposed in our Supplementary Consultation Paper. The power would enable unincorporated charities to change any provision in their governing document by a resolution of the trustees and/or members, save for certain listed alterations (similar to regulated alterations by companies and CIOs) which would require the consent of the Charity Commission. This power would

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<sup>164</sup> See n 109 above.

<sup>165</sup> See para 4.52.

replace the power under section 280 for unincorporated charities to make administrative amendments to their governing documents.

- 4.76 We address below various features of the new amendment power that we recommend and how it will operate. In doing so we note nuances in the position of unincorporated charities that would render complete alignment with the regime for corporate charities ineffective or inappropriate.

#### Relationship with express powers of amendment

- 4.77 Unincorporated charities often have the benefit of express powers to amend their governing documents, which might require particular conditions to be satisfied before the power can be exercised.<sup>166</sup> We do not want to interfere with existing powers. Like sections 275 and 280, the new amendment power should supplement existing powers. Charities might therefore be able to make the same change to their governing document using an express power or the new amendment power.
- 4.78 The regime for unincorporated charities will therefore differ slightly from that for charitable companies and CIOs. Any amendment by a company or CIO (whether it is pursuant to the statutory amendment power or an express amendment power) that is a “regulated alteration” must be approved by the Charity Commission. A similar requirement for Charity Commission approval of all regulated alterations by unincorporated charities would impose an additional burden on charities that can currently make such amendments under express amendment powers without having to obtain such consent. We do not wish to introduce a requirement for Charity Commission consent where it would be possible for trustees to act without it under the current law. Accordingly, under the new regime for unincorporated charities, amendments pursuant to express powers will not require Charity Commission approval, even if – had they been made using the new statutory power – they would have been regulated alterations.

#### Regulated alterations

- 4.79 Our recommended new power will be closely aligned with the position for charitable companies: any amendment to a charity’s governing document will be permitted, subject to obtaining Charity Commission consent to certain defined “regulated alterations”.
- 4.80 There was general agreement amongst consultees that unincorporated charities should not be given the power to make amendments that constitute “regulated alterations” for companies and CIOs without the consent of the Charity Commission. We agree, and we adopt that definition, as modified in accordance with our recommendations above.<sup>167</sup> However, the category of regulated alterations needs supplementing further to account for certain features that are specific to unincorporated charities. Consultees suggested

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<sup>166</sup> See para 4.29.

<sup>167</sup> Paras 4.14 to 4.23. We discuss below the basis on which the Charity Commission would consent to a change of purposes under the new power. The new s 280A, inserted by cl 3 of the draft Bill, expressly provides that a “benefit” does not include remuneration that is authorised under section 185 (see Ch 9) or under s 189 (which allows trustees to purchase indemnity insurance). The equivalent definition of “benefit” for the purposes of regulated alterations by companies and CIOs expressly excludes any benefits obtained under s 185 but is silent on benefits under s 189. For consistency, the draft Bill amends ss 199 and 248 in order to exclude benefits under s 189 from the meaning of “benefit”: sch 3, paras 40 and 41.

three additional regulated alterations, namely amendments which would affect (1) third party rights; (2) permanent endowment; and (3) entrenched provisions. We discuss each of these in more detail below.

(1) *Third party rights*

4.81 Unincorporated charities' governing documents sometimes include protections or rights for third parties and there is currently uncertainty as to the scope of the section 280 power in respect of provisions conferring such rights. The Charity Commission's guidance refers expressly to two situations where third party rights arise, in relation to which it suggests that section 280 cannot be used (unless the third party has ceased to exist):

- (1) changing provisions giving third parties rights to nominate trustees; and
- (2) amending other powers which the governing document states that the trustees can only exercise with the consent of a third party.<sup>168</sup>

4.82 We can see good reasons, as a matter of policy and pragmatism, for the Charity Commission's view; changing or removing the rights of third parties against their will is likely to be controversial and may distort a balance of power that was devised deliberately when the charity was established. We are not however convinced that section 280, as currently drafted, in fact provides any protection for third party rights. Some consultees commented that third party rights should be protected and appeared to view the Charity Commission's current interpretation of section 280 as producing the right result. Only one consultee expressed the view that charities should be able to use section 280 to override third party rights.

4.83 We have concluded that the new amendment power should not be used to override third party rights. The CLA suggested that:

- (1) an amendment which would have required the consent of a third party<sup>169</sup> had it been made pursuant to an express amendment power; and
- (2) an amendment which would "affect the rights under the trusts of the charity of any third party (whether named in the charity's trusts in person or by reference to the holding of an office) who is alive or in existence (as the case may be) at the date on which the resolution is made";

should require that third party's consent, unless the Charity Commission decides that it is unnecessary to obtain their consent.<sup>170</sup> They envisaged that the Charity Commission

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<sup>168</sup> Charity Commission, *Changing your Charity's Governing Document* (CC36) (August 2011), para 3.3.

<sup>169</sup> Though if the clause required the consent of the Charity Commission and the amendment was not a regulated alteration, they thought that the requirement for consent might be dispensed with since, by analogy, the Charity Commission's existing policy is to allow charitable companies to remove requirements for Charity Commission consent to amendments.

<sup>170</sup> Similar suggestions were made by Bates Wells Braithwaite and Anthony Collins Solicitors LLP, the latter suggesting that the requirement to obtain the third party's consent should be subject to a requirement that consent is not to be unreasonably withheld.

might decide that consent is unnecessary if it is impossible or highly impracticable to obtain the third party's consent.

4.84 We agree, and we broadly adopt this approach in our recommendation and draft Bill: see paragraph 4.86 below.

4.85 The CLA suggested that any new amendment power should not be more restrictive than the current law and that therefore only those rights that are currently protected ought to continue to be (see paragraph 4.81 above for the Charity Commission's view on the current scope of section 280). We do not think that, in setting out the scope of regulated alterations, we should necessarily be confined by what is currently thought to fall outside section 280. If an amendment is a regulated alteration, that does not prevent the amendment from being made; rather, it means that the Charity Commission must consent to the amendment (unlike amendments that fall outside the scope of section 280, which cannot be made). It is impossible to provide a statutory formulation that will produce a clear answer in all cases; inevitably there will be some grey areas. But if, in practice, there are doubts as to whether or not a proposed amendment amounts to a regulated alteration, the solution is to treat it as such and seek the Charity Commission's consent.

4.86 The draft Bill provides that:

- (1) an amendment that had it been made under an express power of amendment would have required the consent of a person (other than a trustee or member of the charity) is a regulated alteration, unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence; and
- (2) an amendment that would "affect any right directly conferred" by the governing document on a named person, or the holder of an office or position specified in the governing document (other than that of a trustee or member) is a regulated alteration, again unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence.<sup>171</sup>

Trustees and members are excluded from the definition on the basis that their rights are adequately protected by the requirement that they pass a resolution to exercise the amendment power.

4.87 The following amendments would generally be regulated alterations:

- (1) changing a power for X to nominate trustees for appointment;
- (2) changing a power for X to set the spiritual direction of a faith charity;
- (3) changing a requirement for X to consent to certain decisions or proposed amendments;
- (4) changing a right for X to be consulted on a particular matter;

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<sup>171</sup> Draft Bill, cl 3, inserting s 280A(8)(e) and (f) and s 280A(9) into the Charities Act 2011.

- (5) changing a right for X to receive certain documents;
- (6) changing the named recipient of the charity's property in a dissolution clause; and
- (7) introducing a power to merge in circumstances where Charity X is named as the recipient of property in the event of dissolution, and the creation of the power to merge renders the dissolution clause redundant.

4.88 On the other hand, the following amendments would not be regulated alterations:

- (1) changing the right of trustees to co-opt further trustees (since trustees are excluded from the definition);
- (2) changing the rights of members to appoint or remove trustees, or the requirement for members to ratify certain decisions (since members are excluded from the definition);
- (3) changing the rights of a category of people (such as the residents of a particular neighbourhood) to vote on certain matters (since they are not named persons, and do not hold a particular office or position specified in the governing document); and
- (4) changing provisions that confer benefits on individuals who are not named in the governing document, or provisions that confer indirect benefits, such as the benefits to a supplier of goods or services to the charity being affected by an amendment which causes the charity to stop purchasing those goods or service.

*(2) Permanent endowment*

4.89 Charitable trusts might include property that is permanent endowment, that is, property that is subject to a restriction on being spent. Generally, it must be held in perpetuity and the trustees are permitted to spend the income from the assets, but not the capital. We discuss permanent endowment in Chapter 8. There is a tailored regime in sections 281 and 282 of the Charities Act 2011 that permits trustees to release permanent endowment restrictions;<sup>172</sup> the existence of that tailored regime might suggest that permanent endowment restrictions in governing documents cannot be amended under section 280.<sup>173</sup> Some consultees commented that such restrictions should not be capable of amendment under section 280 (and none said they should be capable of amendment) and that, under an aligned regime, any amendment to such restrictions should require Charity Commission consent.

4.90 We agree that trustees should not themselves be permitted to release permanent endowment restrictions under the new statutory power; we make recommendations in Chapter 8 for reform of the sections 281 and 282 powers which are designed specifically for the release of permanent endowment restrictions, in some cases without the need for Charity Commission consent. But we do not think that amendments to permanent

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<sup>172</sup> See para 8.40 and following.

<sup>173</sup> We also noted, however, the argument that such amendments fall within the wording of s 280: see Consultation Paper, paras 6.7 and 6.8.

endowment restrictions should fall outside the new power altogether; we think that permanent endowment restrictions should fall within the category of provisions that can only be amended under the new power with the consent of the Charity Commission. Under the current law, the Charity Commission might amend permanent endowment restrictions by making an administrative scheme,<sup>174</sup> and such an amendment ought to be possible using the new power – thereby avoiding the need for a scheme – but retaining the requirement of Charity Commission approval. If the proposed amendment can properly be achieved under sections 281 or 282,<sup>175</sup> the trustees are likely to prefer that course (and, in any event, we would expect the Charity Commission to refuse consent under the new amendment power if the proposed amendment could be achieved using the tailored regime for permanent endowment in sections 281 and 282).<sup>176</sup>

### (3) *Entrenched provisions*

4.91 The CLA suggested that two further matters should be protected under a new amendment power. First, the power should not “circumvent any express requirements, statements or entrenched provisions”, thereby providing some consistency with companies which can make provision for entrenchment. We think that it would be difficult to devise an appropriate definition of entrenched provisions to give effect to the CLA’s suggestion. Moreover, such provisions can often already be overridden using the section 280 power. Second, the CLA thought that if an unincorporated charity’s constitution expressly forbids amendment to the objects or any other provision, the charity ought to obtain a scheme to make the amendment. Again, this suggestion would place a limitation on what can already be done under section 280, and we think it unlikely that governing documents for existing charities would often include such a provision, since the drafter is unlikely to have anticipated and provided for an unknown future change to the law.

### *Conclusion*

4.92 Aside from the provisions that we have identified above (namely, existing regulated alterations, and provisions concerning third party rights and permanent endowment), we do not think that the new amendment power should exclude any further provisions or require their amendment to be approved by the Charity Commission.

### Additional safeguards concerning the exercise of the new power

4.93 Our supplementary consultation revealed some concerns about giving trustees a power to change charities’ purposes without having to establish a section 62 *cy-près* occasion in the absence of some further safeguards (in addition to those already discussed above). We have decided to adopt three of these proposed safeguards, which we address in turn below.

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<sup>174</sup> For example, to widen the investment powers of the trustees to include different asset classes.

<sup>175</sup> Which we conclude in Fig 18 (p 230) are not limited to *releasing* the spending restrictions in order that the endowment be spent and never replaced; they would permit charities to release permanent endowment for limited purposes or to hold it as expendable endowment.

<sup>176</sup> The Charity Commission’s general policy is to refuse to exercise its powers if the charity trustees can themselves achieve the desired result without the Charity Commission’s involvement.

*(1) Amendment must be in the best interests of the charity*

4.94 The section 275 power to change a small charity's purposes includes a requirement that the trustees must be satisfied that the amendment is in the best interests of the charity.<sup>177</sup> No such requirement is currently included in section 280. In many ways, it is self-evident that the power can only be exercised if the trustees consider it to be in the best interests of the charity to do so.<sup>178</sup> Nevertheless, we think that there are benefits to adopting the approach in section 275 to put the matter beyond doubt, and to make clear on the face of the statute what the trustees must consider before they use the new power.

4.95 Whilst consultees only suggested adding this express requirement in the context of changes to a charity's purposes, we recommend just one new amendment power which covers all potential changes and which imposes consistent requirements as far as possible. Accordingly, we propose that any amendment under the new power should be subject to the "best interests" test.

*(2) Amendment cannot result in charity ceasing to qualify for charitable status*

4.96 In the case of CIOs, section 225 expressly provides that no amendment to a CIO's constitution can take effect if it would stop the CIO from being a charity. While again this might seem self-evident we can see the benefits of including an equivalent provision in our new power.

*(3) Public notice*

4.97 We discuss at paragraph 4.47 above the publicity requirements for schemes. The Charity Commission, CLA and Bates Wells Braithwaite suggested including something similar under the new power in respect of amendments that would require Charity Commission consent. Specifically, the Charity Commission sought a power which would enable it to require trustees to give public notice of a proposed change or enable it to give public notice itself, prior to granting consent to the amendment. The Commission argued that its ability to give public notice of schemes is particularly important where an amendment raises more controversial issues, such as the disposal of designated land. We recommend that the Charity Commission should have a discretionary power to give notice (or require that notice be given) before deciding whether to consent to a regulated alteration. We recommend below that the Charity Commission should have an equivalent power when deciding whether to consent to regulated alterations by companies and CIOs.

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<sup>177</sup> Charities Act 2011, s 275(4)(a).

<sup>178</sup> We are aware of potential concerns about how the trustees of a charitable trust can be expected to decide whether to seek to change the charity's purposes. The trustees must act in the best interests of the charity; almost by definition, it is contrary to the "interests" of the existing purposes of a charity for them to be replaced with different purposes. We think, however, that a change of purposes requires trustees to act in accordance with a wider concept of the charity's best interests. That is nothing new; such decisions by charity trustees about changing a charity's purposes are required to be made under the current law: (a) under s 275, (b) when a trust includes an express power to change the purposes with the consent of the Commission (as the Commission's model trust deed does), and (c) whenever a company or CIO changes its purposes.

## Excluding, restricting or modifying the new power

4.98 Section 280 currently applies in addition to any express amendment power, and it is the generally accepted view that the section 280 power cannot be excluded or modified by a charity's governing document. Some consultees thought that the new amendment power should be capable of being excluded, particularly in relation to a change of purposes. On balance, we have concluded that it should not be possible to exclude, restrict or modify the new amendment power in a charity's governing document (similarly to section 280 at present) for the following reasons.

- (1) The new power will not enable trustees to amend a charity's purposes on a whim. They have to be satisfied that the amendment is in the best interests of the charity. Moreover, such an amendment will also require the consent of the Charity Commission. As we go on to recommend in paragraph 4.139 below, when deciding whether to give its consent, the Commission will have regard to the desirability of the charity's purposes remaining close to the current purposes, as well as to the need for the purposes to be suitable and effective in the current social and economic circumstances.
- (2) We are recommending an express discretionary power for the Charity Commission to require public consultation in the case of regulated alterations. Therefore, in many cases we would expect trustees to consult (either voluntarily or at the direction of the Commission) with the settlor or other significant individuals before exercising the power.
- (3) Allowing the new amendment power to be excluded would only be of use to future charities as existing charities would be very unlikely to contain express wording that would exclude the application of a power that did not exist at the time of drafting. As Stone King LLP suggested, to allow governing documents to exclude the power would suggest that existing trusts should not be subject to the new regime. But that would, in effect, create a dual regime for existing and future charities, which consultees did not favour.
- (4) The new power has been designed in such a way as to be a suitable default power for all charities, which balances various competing considerations and includes appropriate safeguards.
- (5) In the supplementary consultation most charities agreed that it should be possible for trustees to change the purposes of an unincorporated charity without having to establish a section 62 cy-près occasion. Exclusion of the new amendment power would put trustees back in the position of having to establish a cy-près occasion in order to change the charity's purposes.
- (6) We also think, as a matter of policy, that it is appropriate to have some restriction on dead hand control of charitable funds. If the trustees have decided, within the safeguards of the new power, that the purposes should be changed in the best interests of the charity, the law should not prevent them from making that decision.
- (7) Finally, we do not want to encourage founders to exclude the new power as a matter of course, thereby undermining the utility of the new power.



- 4.99 The principal argument in favour of being able to exclude the new power is a practical one about the possible effect of the new amendment power on the willingness of philanthropists to donate to charity. That concern does not apply to donations that have already been made but rather is a concern about the effect of the new power on future giving. We agree that it is important not to discourage philanthropy but believe that the other policy considerations set out above outweigh any potential risk. In addition, we do not think that the law should encourage philanthropy at all costs; we are not convinced that it is appropriate, in the name of encouraging philanthropy, for the law to prevent charities in years to come from using funds efficiently.
- 4.100 Furthermore, the policy of not allowing the new amendment power to be excluded is tempered by the fact that the new power already caters for certain restrictions in charities' governing documents. It cannot, for example, be exercised to make an amendment that would (if being made under an express power) have required a third party's consent, or would affect the rights of a third party, without the Charity Commission's consent. That qualification to the power means that settlors can, in practice, ensure that certain provisions cannot be amended without (at the very least) Charity Commission consent.

#### Resolutions

- 4.101 It is necessary to consider the resolutions that would be required for an unincorporated charity to exercise the new amendment power. Before doing so, we explain the similarities and differences between the governance structure of corporate and unincorporated charities. Companies and CIOs have a body of members who have a role in approving resolutions to amend the charity's governing document; trusts do not. Accordingly, it is not possible to align precisely the requirements for resolutions under the new amendment power for unincorporated charities with the requirements for resolutions for corporate charities.

#### *Trustees and members*

- 4.102 Unincorporated charities comprise:

- (1) trusts, which:
  - (a) are controlled by the trustees; and
  - (b) have no separate body of members.
- (2) unincorporated associations, which:
  - (a) are controlled by the trustees; and
  - (b) have a separate body of members.

#### 4.103 Charitable companies (and CIOs):

- (1) are controlled by the directors of the company;<sup>179</sup> and
- (2) have a separate body of members (usually guarantors rather than shareholders, since the company will usually be limited by guarantee rather than by shares).

4.104 A charitable company's members might be the same people as its directors (which essentially reflects the trust model); or a charitable company's members might be different from its directors (which essentially reflects the unincorporated association model). Put another way:

- (1) if a charitable trust corporate as a company, the trustees would become both the directors and the members (guarantors) of the company; and
- (2) if an unincorporated association corporate as a company, the trustees would become the directors and the separate body of members would become the members (guarantors) of the company.

4.105 The company law rules concerning resolutions of members were not designed with charities in mind since:

- (1) when the directors and members of a charitable company are the same, there will be no distinction in practice between their roles;<sup>180</sup> and
- (2) the voting rights for shareholders reflect their financial interests in the company as a profit-making entity; by contrast, guarantors of a charitable company have no financial interests in its activities but instead hold the directors to account (assuming they are different people).

4.106 In summary, therefore, the effect of the company law rules is that:

- (1) when the directors and members of a charitable company are the same people, the requirement for a resolution of 75% of the members is effectively the same as requiring a resolution of 75% of the directors; and
- (2) when the directors and members of a charitable company are not the same people, the resolution will be passed by a majority of the directors<sup>181</sup> before being put to the members of the company, 75% of whom must approve the resolution.

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<sup>179</sup> The directors of the company are also the charity trustees for the purposes of the Charities Act 2011, s 177. If the charity is a CIO, they are called simply the "charity trustees".

<sup>180</sup> We acknowledge that directors and shareholders will often also be the same people in the case of small profit-making companies, but the roles are different; the directors decide how to run the company; the shareholding determines voting rights and distribution of profits.

<sup>181</sup> It is possible for resolutions to be passed by the members of a company against the wishes of the directors, but this is unusual.

*The new amendment power: by whom should resolutions be passed?*

- 4.107 Amendments under the new power should require a resolution of the charity's trustees.<sup>182</sup> The trustees are entrusted with the management of the charity and are subject to various duties and it is appropriate that they decide whether to make an amendment under the new power. In the case of trusts, the trustees are the only people who can make a decision for the charity, since there are no members.
- 4.108 If the charity is an unincorporated association with a separate body of members, we think that any amendment should also be approved by them. By analogy, amendments by charitable companies require the approval of the company's members. Moreover, amendments made under section 280 by charitable unincorporated associations currently require the approval of the charity's members. In the Consultation Paper, we noted the anomaly under the current law that a members' resolution is not required for changes to an unincorporated charity's purposes under the section 275 power. Most consultees agreed with our proposal that section 275 should – like section 280 – require a members' resolution.
- 4.109 Two concerns were raised about having to obtain members' agreement to an amendment. First, it can be expensive to contact and arrange for approval by a charity's membership. Some consultees added that the expense can be wasted if the Charity Commission subsequently objects to the amendment. We see the strength of these concerns, but we remain of the view that changes to a charity's governing document should be scrutinised and approved by the charity's members; it is important for the members to be content with any changes,<sup>183</sup> and the members of a charity often have an important role in holding the trustees to account. Moreover, most charities with a membership will hold an annual meeting and proposed amendments can be added to the agenda for such meetings in order to keep costs down. We accept, however, that both time and money can be wasted if the members approve an amendment which is subsequently refused by the Charity Commission. In the case of amendments under the new power that require Charity Commission consent, the trustees will be able to seek that consent before or after passing the resolution and before putting the resolution to a vote of the charity's members.
- 4.110 Second, some charities have a very broad membership who cannot easily be identified or contacted (for example, all former pupils of a school, or graduates of a university; even donors to a charity might be given a notional membership status). We think that the difficulty can be addressed by defining more tightly what is meant by "an unincorporated association with a body of members distinct from the charity trustees", which is the current formulation in section 280. The requirement in section 280 for a resolution of the members of the charity is intended to capture unincorporated associations whose members have a decision-making role and who hold the trustees to account, not charities that offer a notional membership status to individuals without any accompanying decision-making role. The new power limits the right to approve a

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<sup>182</sup> This also reflects the fact that the directors of a charitable company will usually pass a resolution to amend the articles.

<sup>183</sup> The Institute of Chartered Secretaries and Administrators said that, despite the increased costs, involving the members constructively "could mean that any changes have an increased legitimacy within the charity's stakeholders".

resolution to any members entitled to attend and vote at a general meeting of the charity.

*The new amendment power: what majority of trustees and members should be required?*

4.111 There are various different majorities in charity law. Some consultees made a plea for general consistency between them. The majorities of particular relevance in this context are set out in Figure 5.

**Figure 5: majorities for trustees' and members' resolutions in charity law**

- Amendments to governing documents under section 280: resolution of the majority of the trustees and (if the charity has a separate body of members) a resolution of two thirds of the members voting at a general meeting.<sup>184</sup>
- Changes to objects under section 275: resolution of two thirds of the trustees (and no requirement for a members' resolution).
- Amendments to governing documents by charitable companies: resolution of 75% of the members (or unanimity if the provision to be amended has been entrenched).
- Amendments to governing documents by CIOs:<sup>185</sup> resolution of 75% of the members at a general meeting (or unanimity if the resolution is passed otherwise than at general meeting, or if the provision to be amended has been entrenched).
- Releasing permanent endowment restrictions under sections 281 and 282: resolution of the majority of the trustees (and no requirement for a members' resolution).
- Transfer of property under section 268: resolution of two thirds of the trustees (and no requirement for a members' resolution).

4.112 We do not think that it would be appropriate to adopt one majority figure for use throughout charity law; the majority required can properly depend on the significance of the matter. Further, differing majorities are a consequence of whether or not the membership is involved in approving the decision. But we can seek to ensure that there is consistency as far as possible.

4.113 In setting the majorities under the new amendment power, the closest analogies are resolutions under section 280 and resolutions by companies and CIOs to amend their governing documents. The new amendment power is intended to align the position of unincorporated charities with charitable companies and CIOs as far as possible. For a

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<sup>184</sup> Or "by a decision taken without a vote and without any expression of dissent in response to the question put to the meeting": Charities Act 2011, s 280(4).

<sup>185</sup> As well as resolutions to amalgamate CIOs (s 235) and resolutions to transfer a CIO's undertaking to another CIO (s 240).

summary of that position, see paragraphs 4.102 to 4.106 above. Closest alignment with companies and CIOs would require:

- (1) in the case of a charitable trust, a resolution of 75% of the trustees; and
- (2) in the case of a charitable unincorporated association with a separate body of members, a resolution of the majority of the trustees and a separate resolution of 75% of the members who attend and vote on the resolution.

4.114 We make a recommendation accordingly.<sup>186</sup> If the separate body of members is to vote otherwise than at a general meeting, we think that the resolution should require unanimity. We recognise that obtaining the unanimous agreement of an unincorporated association's members would be difficult, but it might be possible in some circumstances and we think that it is worth providing an alternative to having to call a general meeting. A requirement for unanimity mirrors the position for CIOs wishing to make constitutional amendments otherwise than at a general meeting.<sup>187</sup> By contrast, companies only need a 75% majority to make amendments otherwise than at a general meeting, but the Companies Act 2006 includes detailed provisions that ensure all members are given notice of proposed resolutions.<sup>188</sup> A requirement for unanimity avoids the need for detailed requirements about giving notice of proposed amendments to all members.<sup>189</sup>

#### *When should resolutions take effect?*

4.115 Resolutions under section 280 take effect on the date specified in the resolution or, if later, the date on which the resolution is approved by the members of the charity (if any).<sup>190</sup> The same should apply to the new amendment power, save that resolutions that require the consent of the Charity Commission should not take effect until that consent has been obtained.<sup>191</sup> Unlike the position for corporate charities there is no requirement that unincorporated charities register the amendment with the Charity Commission. We do not propose to change this under the new amendment power.

### **The continued role of section 275**

The purpose of section 275

4.116 We now turn to consider whether there is a continued role for section 275<sup>192</sup> following the introduction of a new amendment power for unincorporated charities. The principal justification for section 275 is that it is quicker, cheaper and easier to use than having to obtain a cy-près scheme. As the Independent Schools Council said, obtaining a cy-

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<sup>186</sup> The new power also provides for a decision taken at a general meeting without a vote. In such a case the requirement will be that there is no expression of dissent in response to the question put to the meeting.

<sup>187</sup> Charities Act 2011, s 224(2)(a).

<sup>188</sup> We discuss this distinction in the Analysis of Responses, Ch 6.

<sup>189</sup> In the case of amendments at a general meeting which would only require a 75% majority, the existing requirements in the charity's governing document (for giving notice of proposals to be discussed at a general meeting) would ensure that appropriate notice of the resolution would be given to all members.

<sup>190</sup> Charities Act 2011, s 280(6).

<sup>191</sup> The trustees will have to notify the Charity Commission of the amendments under Charities Act 2011, s 35.

<sup>192</sup> See para 4.28.

près scheme is “a more time consuming and expensive process” than section 275.<sup>193</sup> Under our recommendations, trustees would no longer have to obtain a cy-près scheme in order to change their charity’s purposes; rather, they would pass a resolution and obtain the Charity Commission’s consent. The procedure for all unincorporated charities would therefore be made simpler and less expensive than having to obtain a cy-près scheme. Thus the main justification for retaining section 275 is removed.

#### Advantages of section 275

4.117 There would be only one difference between the procedure under section 275 and under our recommended amendment power,<sup>194</sup> namely that section 275 requires trustees to notify the Charity Commission of the resolution, with a power for the Charity Commission to object, whereas our recommendation requires the Charity Commission actively to give its consent to the amendment. Some consultees said that section 275 was helpful as a “do-it-yourself” power for small charities, without requiring formal Charity Commission consent. But the difference is not significant; in both cases, the Charity Commission will consider the amendment and make a decision as to whether or not it is appropriate.<sup>195</sup>

#### Disadvantages of section 275

4.118 There are several problems with section 275, which became more evident as we analysed consultees’ responses to our questions about expanding its scope.

- (1) The power is intended for small charities but that is not always achieved by the income threshold; Geldards LLP said it had encountered charities that hold assets worth millions of pounds, but which have an annual income of below £10,000 so could fall within the section 275 power. The problem exists despite the exclusion of charities with designated land (see paragraph 4.28),<sup>196</sup> but extending the power to charities with designated land, as we proposed in the Consultation Paper, would exacerbate this problem. Further, creating an additional capital threshold (either instead of, or as well as, excluding charities with designated land) would make the power more complicated and expensive to use. Charities might have to pay for a surveyor or other expert to value the charity’s assets in order to work out whether or not the charity fell above or below the capital threshold.

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<sup>193</sup> Similar comments were made by Francesca Quint, Veale Wasbrough Vizards LLP, the CLA, and the Fellowship of Independent Evangelical Churches.

<sup>194</sup> There would, of course, be significant differences in the pre-conditions for the exercise of the two powers, since s 275 is limited to small charities without designated land, and requires the new purposes to be “similar in character” to the old; none of those pre-conditions would apply under our recommended amendment power.

<sup>195</sup> Assuming the Charity Commission’s procedures operate correctly; we heard reports of charities submitting a s 275 resolution, relying on silence after 60 days, but then being told by the Charity Commission that it had no record of having received the s 275 resolution. We were also told that charities are uncertain whether they can rely on silence after 60 days given that the Commission’s standard response time is often 40 working days (roughly 56 days).

<sup>196</sup> Geldards LLP and the CLA.

- (2) Changes to a charity's purposes should be overseen by the Charity Commission, in particular to ensure that the purposes remain charitable.<sup>197</sup> Arguably that oversight should be greater, not less (as it is under section 275), in the case of small charities. As the National Council for Voluntary Organisations, Association of Charitable Foundations, Charity Finance Group and Institute of Fundraising commented "the potential for the power to be used incorrectly is greater with small charities, since they are less likely to have access to legal advice".<sup>198</sup>
- (3) Many consultees reported that the section 275 power was regularly used in respect of restricted funds, permanent endowment, or gifts by will to charities on the basis that the particular fund was a separate charity (at least where the holding charity is incorporated).<sup>199</sup> Arguably, section 275 is intended for small charities, not small funds held by larger charities.
- (4) As we have noted elsewhere, setting a financial threshold for the use of the power is arbitrary.

## Conclusion

4.119 Companies and CIOs do not have access to a power equivalent to section 275. Consultees who commented on this inconsistency between corporate and unincorporated charities tended to suggest that companies and CIOs should have an equivalent power. But the absence of such a power for companies and CIOs does not mean that they have to fall back on a *cy-près* scheme to change their purposes; they simply need Charity Commission consent to the regulated alteration, which is a procedure that (in stark contrast to the *cy-près* regime for unincorporated charities) was not criticised in consultation.

4.120 We have concluded that the introduction of our recommended amendment power should be accompanied by the repeal of section 275. Our recommended new amendment power removes the need for section 275; if there is no need for a *cy-près* scheme, there is less need for a simplified procedure for small charities as an alternative to a *cy-près* scheme. Further, the difficulties that are created by section 275, and that are thrown up by any expansion of the power, do not justify the minimal benefit (if any) that it would achieve after our recommended amendment power is introduced. Whilst consultees generally favoured expanding section 275 (as we had provisionally proposed) and creating an equivalent power for corporate charities, we agree with the CLA that it should be repealed; "it would be more consistent to have one, simple, process for all".

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<sup>197</sup> The CLA, Charity Commission, Bircham Dyson Bell LLP, and Action with Communities in Rural England.

<sup>198</sup> Similar comments were made by the Churches' Legislation Advisory Service (CLAS), Stewardship, Charities' Property Association, Institute of Chartered Secretaries and Administrators, and Charity Law and Policy Unit (University of Liverpool).

<sup>199</sup> See paras 12.34 and following where we discuss the question whether special trusts and permanent endowment of a charity (whether it is corporate or unincorporated) constitutes a separate charity as a matter of charity law.

### **Recommendation 3.**

4.121 We recommend that:

- (1) in place of section 280 of the Charities Act 2011, unincorporated charities be given a new statutory power to amend any provision in their governing documents, subject to a requirement that the Charity Commission approves the following amendments:
  - (a) amendments that would be “regulated alterations” under section 198 if they were made by a company (as amended in accordance with Recommendation 2 above);
  - (b) any amendment to a restriction that renders property permanent endowment;
  - (c) any amendment that – had it been made under an express power of amendment – would have required the consent of a person (other than a trustee or member), unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence;
  - (d) any amendment that would affect any right directly conferred by the governing document on (i) a named person, or (ii) the holder of an office or position specified in the governing document (other than that of a trustee or member), unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence; and
  - (e) any amendment which would confer power on the charity trustees to make an amendment falling within paragraphs (a) to (d) above;
- (2) in the case of a charitable trust, the power should be exercisable by a resolution of 75% of the trustees;
- (3) in the case of a charitable unincorporated association that has a body of members with an entitlement under the governing document, to attend and vote at a general meeting, the power should be exercisable:
  - (a) by a resolution of a majority of the trustees; and
  - (b) by a further resolution of those members which is passed:
    - (i) at a general meeting, by 75% of those members who attend and vote on the resolution;
    - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the general meeting; or
    - (iii) otherwise than at a general meeting, unanimously;



- (4) in the case of amendments that require the consent of the Charity Commission, the trustees should be able to seek that consent before putting the resolution to a vote of the charity's members;
- (5) amendments should take effect on the later of:
  - (a) the date of the resolution;
  - (b) the date specified in the resolution for it to take effect (if any);
  - (c) the date on which the resolution of the members of the charity is passed (if such a resolution is required); or
  - (d) the date on which the Charity Commission consents to the amendment, (if such consent is required);
- (6) the power should only be exercised where the charity trustees are satisfied that it is expedient in the interests of the charity to pass the resolution;
- (7) the power should not be exercised in any way which would result in the institution ceasing to be a charity;
- (8) the Charity Commission should be given a power to give public notice, or require the charity trustees to give public notice, of any amendment in respect of which the Commission's consent is required; and
- (9) section 275 of the Charities Act 2011 should be repealed.

4.122 Clauses 3 and 41 of the draft Bill would give effect to this recommendation.

#### **The Charity Commission's discretion to consent to a change of purposes**

4.123 We recommend above that the amendment regime governing unincorporated charities be aligned more closely with the amendment regime for companies and CIOs. A charitable company or CIO can only change its purposes with the consent of the Charity Commission. Our recommendation for a new amendment power would permit unincorporated charities to change their purposes with the consent of the Charity Commission as well. We now turn to consider the way in which the Charity Commission should exercise its discretion.

#### The difference between corporate and unincorporated charities

4.124 Currently, when the Charity Commission changes the purposes of an unincorporated charity by way of a cy-près scheme, it must have regard to the section 67 similarity considerations when deciding on the new purposes.<sup>200</sup> By contrast, a change of purposes by a company or CIO simply requires the Charity Commission's consent and the Commission will exercise its discretion according to its policy for the time being. The

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<sup>200</sup> Charities Act 2011, s 67. See para 4.45.

Commission's current policy permits companies and CIOs to make significant changes to their purposes. In considering whether to give consent to a change of purposes, the Charity Commission asks three questions.

- (1) Are the new objects exclusively charitable?
- (2) Is the trustees' decision to make the change a rational one in the circumstances of the charity?
- (3) Do the new objects undermine the previous objects?<sup>201</sup>

4.125 Crucially, as long as the trustees provide a "convincing explanation as to why their proposed changes are in the charity's best interests", the amended purposes can be "significantly different from the existing objects".<sup>202</sup> Similarity between old and new purposes will be relevant to the decision-making process, but it is not given the same importance as under the section 67 similarity considerations.<sup>203</sup>

Should the section 67 similarity considerations be integrated into the new amendment power?

4.126 There are three similarity considerations (set out in Figure 4 above). The first – "the spirit of the original gift" – requires the Commission to examine the motivations behind the original foundation of the charity.<sup>204</sup> The second requires the Commission to consider the similarity between the charity's current purposes<sup>205</sup> and the proposed new purposes. That is to be balanced against the third consideration, which refers to the current social and economic circumstances.

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<sup>201</sup> Charity Commission, *OG518 Alterations to Governing Documents: Charitable Companies* (May 2015) para B5.

<sup>202</sup> Charity Commission, *OG518 Alterations to Governing Documents: Charitable Companies* (May 2015) para B5.1. The Commission will consider the following factors: (1) whether, taking account of the modern social and economic conditions, the proposals seem broadly consistent with what the charity was set up to do; (2) whether the trustees have considered how the objects will be carried out; (3) whether the trustees have taken into account the implications of the proposed change for the charity's members and beneficiaries; and (4) whether the consequences for the charity's beneficial class (future as well as current beneficiaries) have been fully considered: para B5.3.

<sup>203</sup> When considering the second question, the Charity Commission says "the bigger the change, the more convincing a case we will require from the trustees"; "Charitable companies don't need to demonstrate a failure of trusts when changing their objects and so it isn't necessary for us to apply a "cy près" test when we consider such proposals. All that matters is that the new objects are charitable and are not likely to undermine or work against the existing ones. However, the changes must be rational ones for the charity to make. One of the ways we can assess this is whether the proposed objects seem broadly consistent with what they are replacing. If not, the trustees should be able to justify the departure. ... As long as the new objects are not likely to undermine or work against the existing ones, and the trustees can show why they consider the changes to be reasonable in the circumstances of the charity, we should be able to consent to the change." See Charity Commission, *OG518 Alterations to Governing Documents: Charitable Companies* (May 2015) para B5.3.

<sup>204</sup> This is based on the similar wording – the "spirit of the gift" – in the Charities Act 2011, s 62 cy-près occasions. That phrase, in a predecessor statute, was interpreted as meaning "the basic intention underlying the gift, that intention being ascertainable from the terms of the relevant instrument read in the light of admissible evidence": *Re Lepton's Charity* [1972] Ch 276, at 285. See also Charity Commission, *OG2 Application of property cy-près* (March 2012) section A1, paras 3.2 and 4.

<sup>205</sup> The reference to the "original purposes" means, where the original purposes have been altered, the purposes for the time being: Charities Act 2011, s 67(7).

4.127 We suggested in the Supplementary Consultation Paper that the similarity considerations should be applied when the Charity Commission is consenting to a change of purposes under the new amendment power and the majority of consultees agreed with us. These consultees said that the section 67 considerations help to protect the original spirit of the gift and provide clarity for the Charity Commission in deciding whether or not to give consent. They are also familiar to charities and practitioners. Those consultees who were against retaining the similarity considerations were generally in favour of complete alignment between the regimes for corporate and unincorporated charities such that neither section 67, nor section 62 (discussed above) would apply. Stone King LLP argued that the wider regulated alterations test for corporate charities should apply to the proposed new amendment power instead of section 67.<sup>206</sup> By contrast, the Chancery Bar Association criticised the Commission's current approach for corporate charities (discussed further below).

4.128 There is a balance to be struck between allowing charities to remain effective in changing times, and respecting the wishes of founders and donors. The CLA said that a requirement for the Charity Commission to consent to a change of purposes under the new amendment power "provides a suitable safeguard for the wishes of the settlor" and provides "a suitable balance between those wishes and what is expedient in the interests of the charity". In our view, that is best achieved by adopting the section 67 similarity considerations.

4.129 We consider how the section 67 considerations should apply to the new amendment power below. However, it is first necessary to establish whether the similarity considerations (as modified) would apply only to the new amendment power for unincorporated charities or extend to corporate charities as well.

Should the section 67 similarity considerations apply when a company or CIO is changing its purposes?

4.130 Retaining the section 67 similarity requirements for unincorporated charities would leave an inconsistency with the amendment powers of corporate charities, contrary to our policy of aligning the amendment regimes. The Charity Commission's approach to considering a change of purposes by a charitable company would be different from its approach to considering a change of purposes by an unincorporated charity under the new amendment power.

4.131 In the Supplementary Consultation Paper, we said that it is arguable that the position for corporate and unincorporated charities should be aligned by applying the section 67 similarity considerations to a change of purposes by a corporate charity. The two tests are regarded by some consultees as quite similar in practice. It has also been suggested to us that, particularly where there are linked corporate and unincorporated charities, it is difficult to explain to trustees that there are two different tests for a change of purposes. The concern, however, is that such an approach would increase regulation for corporate charities.

4.132 It is possible to justify the retention of two different approaches; our policy is to align more closely the amendment powers of corporate and unincorporated charities but some differences will remain (as we explain above). Moreover, Parliament has

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<sup>206</sup> Plymouth University also supported this view.

previously decided that a change of purposes by corporate charities should only be subject to Charity Commission consent rather than subject to a particular set of considerations specified in the statute.

- 4.133 In the Supplementary Consultation Paper we invited the views of consultees as to whether the Charity Commission should be required to have regard to the section 67 similarity considerations when it decides whether to consent to a company or CIO changing its purposes. As expected, this question caused the most divergence of opinion between consultees, though a majority favoured applying the similarity considerations to changes of purposes by corporate charities.
- 4.134 Those in favour of applying the similarity considerations argued that doing so would provide greater transparency as to how the Charity Commission exercises its discretion to consent to a change of purposes. They said that this increase in certainty would outweigh the slight increase in regulation. They criticised the current test for corporate charities, saying that there is little, if any, legislation or case law endorsing the Commission's current approach. By contrast, some consultees preferred the Charity Commission's approach for corporate charities and thought that applying the similarity considerations to corporate charities would be an unjustified increased burden.
- 4.135 The arguments are evenly balanced, and we acknowledge the concern about an increase (or at least a perceived increase) in regulation. On balance, however, following our supplementary consultation on the question, we think that the Charity Commission's approach to deciding a change of purposes by a charity should be the same whether it is corporate or unincorporated, and we think that the section 67 similarity considerations strike the right balance between protecting donors' wishes and allowing charities to adapt to change. From the perspective of protecting the wishes of donors, little if any attention will be paid to the legal form of the charity to which they are donating (and therefore the basis on which the purposes of the charity could be changed). We have therefore concluded that corporate charities should be subject to the same section 67 similarity considerations when changes are made to their objects.

*Public notice*

- 4.136 We recommend above that, when the Charity Commission is required to give consent to a proposed amendment under the new amendment power for unincorporated charities, it should have a discretionary power to give notice of the proposed amendment (or require that notice be given) before deciding whether to give consent.<sup>207</sup> For consistency, we recommend that the Charity Commission should have the same power when deciding whether to consent to a change of purposes, or any other regulated alteration, by a company or CIO.

How should the similarity considerations apply to the new amendment power for unincorporated charities and to companies and CIOs?

- 4.137 We have concluded that the section 67 similarity considerations should be integrated both into the new amendment power for unincorporated charities and the existing powers for corporate charities. However, the section 67 considerations as currently drafted were designed for situations where trust property is being applied cy-près, rather

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<sup>207</sup> See para 4.96, 4.97 and 4.121(8).

than changing the purposes of a charity (and in particular a corporate charity). The similarity considerations cannot, therefore, be sensibly integrated in their current form into the new power.

4.138 In particular the first consideration, “the spirit of the original gift”, will not be relevant in every change of purposes context as there will not always be an “original gift”. This consideration points to an examination of the reasons why the charity was first established. We therefore recommend alternative wording which captures the same idea but is applicable in a wider context: “the original purposes of the charity” when it was established.<sup>208</sup>

#### **Recommendation 4.**

4.139 We recommend that:

- (1) when considering whether to consent to:
  - (a) a company or CIO changing its purposes under sections 198 and 226 of the Charities Act 2011; and
  - (b) an unincorporated charity changing its purposes under the new amendment power that we recommend above;

the Charity Commission should be required to have regard to the following matters:

- (a) the purposes of the charity when it was established;
  - (b) the desirability of securing that the property is applied for charitable purposes which are close to the purposes being altered; and
  - (c) the need for the relevant charity to have purposes which are suitable and effective in the light of current social and economic circumstances; and
- (2) the Charity Commission should be given a power to give public notice, or require the charity trustees to give public notice, of any amendment by a charitable company or CIO in respect of which the Commission’s consent is required.

4.140 Clauses 1(3), 2(3), 3(2), and 41 of the draft Bill would give effect to this recommendation.

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<sup>208</sup> We do not recommend any amendment to Charities Act 2011, s 67 itself as we believe that it still serves a purpose where charities apply for a cy-près scheme instead of using the amendment power.

## Continuing role of schemes and the law of cy-près

### Schemes

- 4.141 The effect of our recommendations will be that the need for unincorporated charities to obtain cy-près and administrative schemes to make changes to their governing documents will be significantly reduced. We do not, however, suggest that the scheme making power of the court or Charity Commission be removed. There would remain situations in which the Charity Commission would be asked to make a cy-près scheme. For example, if a charitable gift by will is impossible or impracticable, the Charity Commission would continue to make a cy-près scheme to direct that gift to similar charitable purposes.<sup>209</sup> Similarly, there may be situations in which charities will want to effect a change to their governing document by way of a Charity Commission scheme rather than by exercising the new amendment power.
- 4.142 The Charity Commission gives public notice of some proposed schemes before they are made.<sup>210</sup> Schemes will generally be publicised if they are potentially controversial. The reduced call for Charity Commission schemes as a result of our recommendations for reform could result in less publicity of proposed changes to governing documents. But if an amendment under the new power requires the Charity Commission's consent (such as a change to the charity's purposes), the Commission would have a power to require the charity to give notice of the proposed amendment before consenting to the change, in the same way that it currently requires trustees to consult before it will make a scheme:<sup>211</sup> see paragraph 4.97. Finally, it will remain good practice for charities (of any legal form) to carry out appropriate consultation with members, beneficiaries and other interested individuals and organisations, before making constitutional changes.

### Section 67 similarity considerations

- 4.143 Our new amendment power retains (in a slightly modified form) the section 67 similarity considerations. And when, in those rarer cases, the Charity Commission makes a cy-près scheme, the section 67 similarity considerations will still apply.

### Section 62 cy-près occasions

- 4.144 Under our new amendment power, unincorporated charities will have the power to change their purposes without having to establish a section 62 cy-près occasion. In the Supplementary Consultation Paper we asked whether, on that basis, there is any continuing need for section 62.
- 4.145 The section 62 cy-près occasions are effectively redundant in the case of cy-près schemes that are made following the initial failure of a charitable gift. By definition, an initial failure only arises if a charitable gift cannot be put into effect, so it will fall within the section 62(1)(a)(ii) or (b) cy-près occasion.<sup>212</sup> In the case of subsequent changes to a charity's purposes, our new amendment power would remove the relevance of the section 62 cy-près occasions; unincorporated charities will not need to establish the

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<sup>209</sup> Assuming the gift revealed a "general" or "paramount charitable intention", which is a pre-condition to a cy-près scheme in the case of initial failure of the charitable gift: see para 4.39.

<sup>210</sup> Charities Act 2011, s 88; see para 4.47.

<sup>211</sup> Charity Commission, *OG500 Schemes* (January 2017), paras B4 and B10.

<sup>212</sup> See para 4.42 and Fig 3.

existence of a section 62 cy-près occasion in order to exercise the new amendment power.

- 4.146 If the section 62 cy-près occasions are retained, the result would be that charities would have a wider power to change their purposes (under our recommended new amendment power) than the Charity Commission would have pursuant to a cy-près scheme. Arguably, retaining the section 62 cy-près occasions would be an unnecessary and illogical constraint on the Charity Commission's powers. It would be possible to remove the need for the Charity Commission to establish one of the section 62 cy-près occasions before making a cy-près scheme. On such an approach, the section 67 similarity considerations should still apply when the Commission decides on the charity's new purposes.
- 4.147 But retaining the section 62 cy-près occasions would not necessarily be problematic, since we expect that a change of purposes will generally be undertaken using the new amendment power rather than by way of a cy-près scheme. Moreover, the power to make cy-près schemes arises not just on the application of the trustees, but it can also be exercised on the application of certain other people or on the Commission's own motion.<sup>213</sup> Whilst it would be consistent to remove the need for section 62 cy-près occasions when the application is made by the charity's trustees, we are not convinced that the same can be said when the scheme is made on the application of a third party or of the Commission's own motion.
- 4.148 It would not be anomalous for the trustees of a charity to have a power to make a change which the Charity Commission could not itself make. The power for small charities to change their purposes under section 275 can be exercised without having to establish a section 62 cy-près occasion.<sup>214</sup> The trustees can therefore make some changes under section 275 (with Charity Commission oversight built into the process) which the Commission could not itself make by way of a cy-près scheme.
- 4.149 In the Supplementary Consultation Paper we suggested that the policy considerations behind expanding trustees' own powers of amendment might be different from those concerning the exercise of the Commission's scheme-making powers. As a result, we proposed retaining the section 62 cy-près occasions as pre-conditions to the Charity Commission making a cy-près scheme.
- 4.150 The vast majority of consultees agreed with our proposal. Lord Hodgson argued against it, describing section 62 as creating another hurdle inhibiting change which should therefore be removed. However, other consultees recognised the continued (if reduced) need for section 62 where a scheme is made on the application of a third party or of the Commission's own motion.
- 4.151 Following this additional consultation we have concluded that section 62 cy-près occasions should remain as pre-conditions to the Charity Commission making a cy-près scheme.

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<sup>213</sup> Charities Act 2011, s 70. There is an obligation on the trustees of a charity to apply for a cy-près scheme in certain circumstances: s 61.

<sup>214</sup> See paras 4.28 to 4.31.

## EFFECT OF OUR REFORMS

Type of amendment	Current law	Changes following our reforms
Charitable companies and CIOs		
Changing purposes	Statutory power to amend by resolution of the members <ul style="list-style-type: none"> <li>• Regulated alteration</li> <li>• Requires Charity Commission consent: discretion exercised according to its policy for the time being</li> </ul>	Statutory power to amend by resolution of the members <ul style="list-style-type: none"> <li>• Regulated alteration</li> <li>• Requires Charity Commission consent: discretion to give consent exercised having regard to:               <ol style="list-style-type: none"> <li>(1) the purposes of the company/CIO when it was established;</li> <li>(2) the desirability of securing that the purposes of the company/CIO are similar to the purposes being altered; and</li> <li>(3) the need for the company/CIO to have suitable and effective purposes in the current social and economic circumstances</li> </ol> </li> </ul>
Altering provisions concerning the distribution of property on dissolution  Authorising benefits to trustees or members (“Regulated alterations”)	Statutory power to amend by resolution of the members <ul style="list-style-type: none"> <li>• Regulated alteration</li> <li>• Requires Charity Commission consent: discretion exercised according to its policy for the time being</li> </ul>	No change
Other amendments	Statutory power to amend by resolution of the members <ul style="list-style-type: none"> <li>• Not a regulated alteration</li> <li>• No requirement for Charity Commission consent</li> </ul>	No change



Type of amendment	Current law	Changes following our reforms
Unincorporated charities		
<p>Changing purposes</p>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>Statutory power for certain small charities to amend by resolution:</p> <ul style="list-style-type: none"> <li>• Requires notice to be given to the Charity Commission</li> </ul> <p><b>Or</b></p> <p>Apply to the Charity Commission for a cy-près scheme:</p> <ul style="list-style-type: none"> <li>• Establish a section 62 cy-près occasion</li> <li>• Scheme to be made having regard to the section 67 similarity considerations</li> </ul>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>New statutory power to amend by resolution under section 280A</p> <ul style="list-style-type: none"> <li>• Regulated alteration</li> <li>• Requires Charity Commission consent: discretion to give consent exercised having regard to:               <ol style="list-style-type: none"> <li>(1) the purposes of the charity when it was established;</li> <li>(2) the desirability of securing that the purposes of the charity are similar to the purposes being altered; and</li> <li>(3) the need for the charity to have suitable and effective purposes in the current social and economic circumstances</li> </ol> </li> </ul> <p><b>Or</b></p> <p>Apply to the Charity Commission for a cy-près scheme:</p> <ul style="list-style-type: none"> <li>• Establish a section 62 cy-près occasion</li> <li>• Scheme to be made having regard to the section 67 similarity considerations</li> </ul>
<p>Amending provisions concerning the distribution of property on dissolution</p> <p>Authorising benefits to trustees or members</p> <p>Altering a restriction making property permanent endowment</p> <p>Requiring a person's consent</p> <p>Affecting rights directly conferred on named persons or holders of an office/position</p>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>Apply to the Charity Commission for an administrative scheme</p>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>New statutory power to amend by resolution under section 280A</p> <ul style="list-style-type: none"> <li>• Regulated alteration</li> <li>• Requires Charity Commission consent: discretion to give consent exercised according to the Charity Commission's policy for the time being</li> </ul> <p><b>Or</b></p> <p>Apply to the Charity Commission for an administrative scheme</p>
<p>Other amendments</p>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>(In some cases) statutory power for charities to make certain administrative amendments by resolution</p> <p><b>Or</b></p> <p>Apply to the Charity Commission for an administrative scheme</p>	<p>Express power in governing document</p> <p><b>Or</b></p> <p>New statutory power to amend by resolution under section 280A</p> <ul style="list-style-type: none"> <li>• Not a regulated alteration</li> <li>• No requirement for Charity Commission consent</li> </ul> <p><b>Or</b></p> <p>Apply to the Charity Commission for an administrative scheme</p>

# Chapter 5: Charities governed by statute or Royal Charter: changing purposes and amending governing documents

## INTRODUCTION

- 5.1 There are well-established and relatively simple procedures by which the most common forms of charity<sup>215</sup> can change their purposes and amend their governing documents. In Chapter 4, we made recommendations to align, rationalise and further simplify those procedures. In this chapter, we consider the ability of charities<sup>216</sup> established or governed by statute or Royal Charter to make similar changes; they must currently satisfy different requirements and engage with a convoluted procedure to change the provisions in their governing documents.<sup>217</sup>
- 5.2 There are three principal differences between the process by which statutory and Royal Charter charities amend their governing documents and the process applicable to other charities.
- (1) Charity trustees of statutory and Royal Charter charities are given less autonomy. Amendments are subject to the oversight of three different bodies: the Charity Commission, the Office for Civil Society in the Department for Digital, Culture, Media and Sport (“DCMS”), and (in the case of statutory charities) Parliament or (in the case of Royal Charter charities) the Privy Council.
  - (2) There is a single procedure for all amendments, whereas the processes for other charities distinguish between major and minor amendments, the former requiring more scrutiny than the latter.
  - (3) Most charities can seek a Charity Commission scheme to make an amendment if no other power is available to them. That involves some additional time and expense, which can be unpopular with charities, and on which we comment in Chapter 4. But it is a familiar and relatively straightforward process when compared with the process for statutory and Royal Charter charities who must comply with the additional requirement that a scheme be approved by Parliament or by the Privy Council (as the case may be).
- 5.3 In this chapter, we summarise the procedures that statutory and Royal Charter charities must follow, the criticisms that have been levelled at them and our provisional proposals for their reform. We then discuss consultees’ responses and make recommendations for both law reform and for the provision of guidance which, together, would create a

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<sup>215</sup> Charitable companies, CIOs, trusts and unincorporated associations.

<sup>216</sup> Or governing bodies of charities.

<sup>217</sup> A charity’s governing document may comprise multiple documents, such as a Royal Charter, supplemental Royal Charters, bye-laws and regulations. References to a charity’s “governing document” are to all of its governing documents, unless we expressly distinguish between different categories of governing document.

simpler and more transparent process for such charities to undertake constitutional change. Finally, we consider the special position of higher education institutions.

## THE CURRENT LAW

### Statutory charities

- 5.4 Where a charity is established or governed by statute, its governing document (or one of its governing documents) is an Act of Parliament. Some statutory charities were established by Act of Parliament;<sup>218</sup> others that were not established by statute are nevertheless governed by an Act which was passed in respect of the charity.<sup>219</sup> In the absence of any express power to amend a statute, the governing document can only be amended by a further Act of Parliament.<sup>220</sup> That requires Parliamentary time and can be a long and expensive process for the statutory charity wishing to make the amendment.
- 5.5 Section 73 of the Charities Act 2011 provides a mechanism by which a statute establishing or regulating a charity can be amended by secondary legislation (“the section 73 procedure”).<sup>221</sup> The procedure requires the Charity Commission to prepare a scheme – in much the same way that it prepares schemes for other charities<sup>222</sup> – that alters the provision made by an Act establishing or regulating a charity. The scheme is then given effect by order of the Secretary of State.<sup>223</sup> If the statute establishing the charity is a public general Act, the order must be approved by a resolution of both Houses of Parliament (“the affirmative procedure”).<sup>224</sup> If it is a private Act, the order must be laid before both Houses of Parliament and is subject to annulment by a resolution of

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<sup>218</sup> The Act may incorporate a new charity, as with the National Trust, or it may transform one or more existing charities into a single corporation. The Church Commissioners, for example, were established under the Church Commissioners Measure 1947 (1947 No 2 (Regnal 10 & 11 Geo 6)), merging the Governors of the Bounty of Queen Anne for the Augmentation of the Poor Clergy (originally established by the Queen Anne's Bounty Act 1703) and the Ecclesiastical Commissioners (originally established by the Ecclesiastical Commissioners Act 1836).

<sup>219</sup> An example is the Corporation of the Hall of Arts and Sciences, the charity responsible for the maintenance of the Royal Albert Hall. It was initially incorporated in 1866 by Royal Charter, but most of its constitution is now set out in the Royal Albert Hall Act 1966. Similarly, the Bridge House Estates was established by Royal Charter in 1282 but is now largely governed by a series of 19th and 20th century Acts.

<sup>220</sup> For example, the Royal Medical Foundation of Epsom College was governed by the Royal Medical Benevolent College Act 1855, which was later amended by the Royal Medical College Act 1894. The court and Charity Commission cannot make a scheme to amend provision made by an Act of Parliament (unless Parliament provides express authorisation, on which see below), since Parliament is sovereign over the courts and the Commission. Moreover, the powers to change purposes under the Charities Act 2011, s 275, and to amend administrative provisions under the Charities Act 2011, s 280, do not apply to a corporate body, so are of no assistance to charities incorporated by statute or Royal Charter. It has, however, been suggested to us by Francesca Quint that s 280 can be used to amend an Act (and, presumably, also a Royal Charter) that incorporates the body of trustees but not the charity itself, since the charity remains unincorporated. There is no authority on whether s 280 has this effect.

<sup>221</sup> The power was introduced by the Charities Act 1960, s 19, and then appeared in the Charities Act 1993, s 17. We summarised the s 73 schemes that have been made over the last 12 years in the Consultation Paper, Fig 4 (p 32).

<sup>222</sup> See para 4.37 and following.

<sup>223</sup> Charities Act 2011, s 73(1) and (2).

<sup>224</sup> Charities Act 2011, s 73(4).

either House (“the negative procedure”).<sup>225</sup> Most orders under section 73 follow the negative procedure.

- 5.6 Where a scheme is given effect by an order under the negative procedure (that is, where it is made in respect of a private Act), the Charity Commission or court can amend that scheme as if it were a scheme brought into effect by order of the Commission under section 69.<sup>226</sup> In effect, therefore, once a scheme amending a statute has been made and given effect by order, further amendments to that scheme do not require Parliamentary oversight. The further amendment must be an amendment of the scheme itself, and not the original Act. Accordingly, if the scheme is limited to certain issues, and parts of the original Act remain, only the issues addressed in the scheme can be amended by a further scheme.<sup>227</sup>
- 5.7 Whilst the section 73 procedure appears relatively straightforward, in practice there are numerous steps to be taken and various parties are involved: they are set out in Figure 6. Both the Charity Commission and DCMS have significant roles, but neither require any payment from a charity in respect of their involvement in the process.

**Figure 6: statutory charities – the section 73 procedure**<sup>228</sup>

(1) The pre-application phase

After discussions with the charity, the Charity Commission is satisfied that there is a need for a scheme, but no invitation to submit a formal application for a scheme is made.

The responsible Charity Commission lawyer submits a proposal to draft a scheme to the Commission’s Director of Legal Services, who considers whether the scheme should be brought to the attention of the Legal Board or to two legally-qualified members of the Board and whether the proposal is exceptional such that it should be brought to the attention of the Office for Civil Society at DCMS at an early stage.

Once the proposal to draft a scheme has been approved, a formal application for a scheme is invited from the charity.

(2) The application

The charity submits an application for a scheme with a copy of the resolution of the trustees. The Commission must be informed of any charity trustees who are not party

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<sup>225</sup> Charities Act 2011, s 73(3).

<sup>226</sup> Charities Act 2011, s 73(5). The same applies to a scheme given effect by an order under the affirmative procedure (that is, it is made in respect of a public general Act) unless the scheme requires any further amendment to be by way of the affirmative procedure: Charities Act 2011, s 73(6).

<sup>227</sup> One consultee suggested that there was uncertainty as to whether the power in s 73(5) to amend an existing s 73 scheme was so limited. We consider the scope of s 73(5) to be sufficiently clear from the wording of s 73 and do not consider that reform is warranted to make the position any clearer.

<sup>228</sup> This summary is based on s 73 itself, Charity Commission guidance, and our discussions with the Charity Commission and DCMS.

or privy to the decision because it is under a statutory obligation to notify them of its intention to settle a scheme.<sup>229</sup>

(3) The drafting phase

The provisional text of the scheme is drafted by the Commission lawyer (unless the charity asks to provide its own draft) and is sent to the charity and to DCMS for comment.

DCMS considers and comments on whether there are any matters that might cause problems during the Parliamentary process.

The parties agree on the wording of the draft scheme. DCMS is asked to draft the Order that will give effect to the scheme.

(4) The publicity and modification phase

The Commission considers whether the draft scheme should be published by the charity.<sup>230</sup> This entails giving public notice of the scheme and inviting representations to be made within a period specified in the notice.

Any representations made within the notice period must be taken into account. The Commission then decides whether to settle the scheme either without modifications or with such modifications as it thinks desirable.<sup>231</sup> The Charity Commission will liaise with the charity and DCMS in respect of any modifications.

(5) Final internal approval

The revised scheme and draft Order are submitted to the Director of Legal Services for scrutiny and comment. The Director may refer it to either the entire Board or to two legally-qualified members of the Board at this stage. The scheme is approved but it is not settled.

(6) Submission to DCMS

On approval, the scheme and draft Order are submitted by the Chair of the Commission to DCMS in an agreed form. The Commission provisionally settles the scheme subject to approval by DCMS.

(7) DCMS approval and settlement

When DCMS approval is received, the scheme is settled and can be signed by the Director of Legal Services from the date of approval.

(8) Parliamentary phase

DCMS is asked to table the draft Order before both Houses of Parliament.

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<sup>229</sup> Charities Act 2011, ss 71(1) and 73(7).

<sup>230</sup> Charities Act 2011, s 88.

<sup>231</sup> Charities Act 2011, s 88(5).

*Affirmative procedure.* Where the Act in question is a public general Act, the draft Order must be approved by a resolution of each House.<sup>232</sup> Once approved, the Order comes into force.

*Negative procedure.* Where the Act in question is a private Act, the Order is made by the Secretary of State and laid before Parliament. The Order will come into force on its specified commencement date, which will usually be at least 21 days after it is laid. The order will, however, be revoked if either House passes an annulment resolution within 40 days of it being laid.<sup>233</sup>

5.8 There is no distinction between amendments to the charity's purposes and other amendments; any amendment to the governing document, no matter how significant, or insignificant, must follow the same procedure.

### **Royal Charter charities**

5.9 Royal Charter charities' governing documents typically comprise:

- (1) the Royal Charter, and any supplemental Charters;
- (2) bye-laws (sometimes known as rules or statutes); and
- (3) regulations (sometimes known as ordinances).

5.10 There is no clear delineation between the matters that are set out in Charters, bye-laws and regulations. The Charter will often formally incorporate the charity and set out its purposes and powers; the bye-laws might set out the charity's governance structure; and the regulations tend to concern internal procedures.

5.11 The Privy Council Office ("PCO") has a significant role in respect of amendments to Charters and bye-laws, but does not require any payment from a charity in respect of its involvement (save that, as we discuss below, charities are required to pay for their Charter and any supplemental Charters to be printed on vellum). The PCO has emphasised to us that it always encourages Charter bodies to contact the Office at an early stage in order to discuss proposed amendments.

(1) Amending a charity's Royal Charter

5.12 A charity's Royal Charter may be amended:

- (1) pursuant to a power of amendment in the Charter ("the express power procedure");

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<sup>232</sup> Charities Act 2011, s 73(4). Before being laid in Parliament, the draft Order will also be submitted to the Chair of the Joint Committee on Statutory Instruments.

<sup>233</sup> Charities Act 2011, s 73(3); Statutory Instruments Act 1946, s 6(1).

- (2) by the grant and acceptance of a supplemental Charter (“the supplemental Charter procedure”);
- (3) by Order of the Queen in Council giving effect to a scheme made under section 68 of the Charities Act 2011 (“the section 68 procedure”); or
- (4) by Act of Parliament.<sup>234</sup>

Each is considered below.

5.13 As with statutory charities, the relevant procedure must be followed irrespective of the amendment sought though, as noted above,<sup>235</sup> provisions of minor importance will not usually appear in the Charter.

(A) *The express power procedure*

5.14 Many Royal Charters contain a power of amendment. This can typically be exercised by resolution of the charity trustees or members of the charity, always subject to the approval of the Queen in Council.<sup>236</sup>

5.15 The procedure that charities must follow is set out in guidance issued by the PCO, which is summarised in Figure 7.

**Figure 7: Royal Charter charities – the express power procedure**

(1) Initial contact with the PCO

Royal Charter charities are advised to consult with the PCO before any amendment resolution is passed, as this “allows the Privy Council’s advisers to provide informal comments and help shape proposed amendments before they are put to the members for approval”. A failure to do so increases the risk of the Privy Council refusing to approve a proposed amendment, which can result in delay and expense for the charity.

(2) Consultation between the PCO and interested bodies

The PCO will consult Government departments with a policy interest in the Royal Charter body. It will also consult the Charity Commission where the proposed amendments will make “material changes” to the objects of the charity, the name of the charity, the payment of the trustees (other than out-of-pocket expenses) or the dissolution clause.

<sup>234</sup> Royal Charters that have been confirmed by an Act of Parliament can only be amended by the first three procedures in so far as the amendment is not inconsistent with the confirming Act: *R v Miller* [1795] 101 ER 547, 551, by Lord Kenyon CJ; *Halsbury’s Laws of England* (5th ed 2010) Vol 24 para 341. Any amendment that would run counter to the Act must be made by Act of Parliament or following the s 73 procedure.

<sup>235</sup> See para 5.10.

<sup>236</sup> For example, see the Royal Charters of the Royal National Institute of Blind People (RNIB), art 10, available at <http://www.rnib.org.uk/about-rnib-who-we-are/how-we-are-governed>; the Royal British Legion, art 20; the British Red Cross Society, art 15; the National Society for the Prevention of Cruelty to Children (“the NSPCC”), art 21; and the Royal Society for the Protection of Birds (“the RSPB”), art 9.

(3) Informal response from the PCO

The PCO will give an informal response to the charity indicating that the proposed amendment is likely to be approved (with or without modifications) or rejected.

(4) Resolution passed

The charity trustees pass the resolution and (if appropriate) members of the charity approve it.

(5) Submission of resolution to the PCO

The charity trustees submit the resolution together with a certificate confirming that it has been passed in accordance with the Royal Charter.

(6) Approval by the Queen in Council

The resolution will be put before the Privy Council for approval by the Queen in Council at one of the nine Privy Council meetings held each year.

*(B) The supplemental Charter procedure*

5.16 If a Royal Charter does not itself make provision for its amendment, it can be varied by the grant and acceptance of a supplemental Charter.<sup>237</sup> Charities wishing to amend their Royal Charters in this way must petition the Queen in Council for a supplemental Charter. Supplemental Charters are granted by the Queen in Council at common law<sup>238</sup> in much the same way as a first Royal Charter: see Figure 8. A supplemental Charter may add to, remove from, or amend provisions in the original Charter, or it may entirely replace the original Charter.<sup>239</sup>

**Figure 8: Royal Charter charities – the supplemental Charter procedure**

(1) Initial contact with the PCO and other interested bodies

Royal Charter charities are advised to consult with the PCO, and other interested bodies, before making a formal petition for a new or supplemental Charter.<sup>240</sup>

(2) Submission of formal petition

The charity submits a formal petition for a supplemental Charter to the PCO.

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<sup>237</sup> *Ware v The Grand Junction Water Works Co* [1831] 39 ER 472, 477, by Lord Brougham LC.

<sup>238</sup> See para 2.7.

<sup>239</sup> Save that the original incorporation of the body would be carried forward in the supplemental Charter.

<sup>240</sup> Privy Council Office, *Applying for a Royal Charter*, available at <http://privycouncil.independent.gov.uk/Royal-Charter/applying-for-a-Royal-Charter/>.



(3) Publication of the formal petition

The PCO publishes the formal petition in the London Gazette for eight weeks, inviting interested bodies to comment.

(4) Other consultation

The PCO will also consult Government departments and the Charity Commission in the circumstances outlined in Figure 7 above.

(5) Consideration of comments and counter-petitions

The PCO will consider comments and counter-petitions received by interested bodies. The guidance states that “any proposal which is rendered controversial by a counter-petition is unlikely to succeed”.

(6) Approval by the Queen in Council

If the petition is uncontroversial, or any controversies are resolved, a supplemental Charter will be granted by the Queen in Council.

5.17 The charity is required by the Privy Council to pay to print the supplemental Charter on vellum which generally costs the charity around £300 per page. A supplemental Charter could be one page (if it makes one minor amendment) or 10 pages (it is makes more significant amendments or involves a re-print of the bye-laws).

*(C) The section 68 procedure*

5.18 Section 68 of the Charities Act 2011 provides an alternative mechanism for amendment of a charity’s Royal Charter by Order of the Queen in Council giving effect to a scheme. The court or Charity Commission<sup>241</sup> drafts a scheme that “does not purport to come into operation unless or until Her Majesty thinks fit to amend the Charter in such manner as will permit the scheme or that part of it to have effect”.<sup>242</sup> The scheme will be submitted to the Privy Council, and the Queen may amend the charity’s Royal Charter by Order in Council in any way in which the Charter could be amended by the grant and acceptance of a further Charter.<sup>243</sup>

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<sup>241</sup> Charities Act 2011, s 68(2)(a) and (3)(a). This section refers only to the court, but the Charity Commission has concurrent jurisdiction with the court under s 69(1).

<sup>242</sup> Charities Act 2011, s 68(2)(b). A proposed scheme must be publicised, unless the Charity Commission considers this to be unnecessary: Charities Act 2011, s 88.

<sup>243</sup> Charities Act 2011, s 68(4). Any such Order in Council may be revoked or varied in the same manner as the Charter it amends: Charities Act 2011, s 68(3) and (4).

(D) Amendment by Act of Parliament

5.19 Any Royal Charter may be amended or revoked by an Act of Parliament.<sup>244</sup> An Act that amends a Royal Charter could itself be amended using the section 73 procedure,<sup>245</sup> but we are not aware of this ever having occurred.

(2) Amending bye-laws

5.20 Bye-laws can be made or amended pursuant to an express power in the Royal Charter or pursuant to the common law power for corporations to make bye-laws for carrying out their purposes.<sup>246</sup>

5.21 Where the Royal Charter contains an express power to make bye-laws, the charity must comply with any conditions concerning the exercise of that power.<sup>247</sup> The Privy Council's guidance suggests that amendments to bye-laws always require the approval of the Privy Council.<sup>248</sup> That is correct where – as in most cases – the power to make bye-laws is contained in the Royal Charter and expressly requires the charity to obtain the Privy Council's consent. But where the Royal Charter confers a power to make bye-laws without imposing conditions, or where it is silent on the power to make bye-laws and so the charity must rely on its common law power, it is our view that the charity can make and amend bye-laws without the Privy Council's consent.<sup>249</sup> We make a recommendation below that the guidance provided by the Privy Council be amended to reflect this.

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<sup>244</sup> *Re Islington Market Bill* [1835] 6 ER 1530.

<sup>245</sup> See Fig 6 above.

<sup>246</sup> *Norris v Staps* [1616] 80 ER 210; *R v Westwood* [1830] ER 76, 81, by Parker J; 90, by Gaselee J; and 94, by Littledale J.

<sup>247</sup> The Charter will often state that the Privy Council must consent to any amendment to the bye-laws: see for example the Royal Charters of the British Red Cross Society, art 16; the NSPCC, art 16; the RNIB, art 7(1) and para 44 of its bye-laws; and the RSPB, art 8.

<sup>248</sup> "Amendments to Charters can be made only with the agreement of The Queen in Council, and amendments to the body's by-laws require the approval of the Council (though not normally of Her Majesty)": Privy Council, *Chartered bodies*, available at <http://privycouncil.independent.gov.uk/Royal-Charters/Chartered-bodies/>.

<sup>249</sup> For example, art 17 of the Royal Charter of the Royal British Legion provides that the Rules (the bye-laws) can be amended by special resolution of the Annual Conference which has been approved by a special resolution of the trustees, and art 18 provides that the Governing Regulations (the regulations) can be amended by special resolution of the trustees. The validity of amendments to the bye-laws of a Royal Charter charity was considered by the Court of Appeal in *Knowles v Zoological Society of London* [1959] 1 WLR 823. The case concerned the meaning of the words "majority of fellows entitled to vote" on an amendment to the bye-laws of the Zoological Society of London, rather than whether any such amendment required the approval of the Privy Council. However, there was nothing in the Society's Royal Charter, or in any of the judgments of the members of the Court of Appeal, to suggest that amendments to the bye-laws of the Society had to be approved by the Privy Council. By contrast, the judgment of Lord Evershed MR is clear that amendments to the Society's Charter would be "subject to the approval of His Majesty in Council of the amendment": [1959] 1 WLR 823, 826. The Master of the Rolls expressed no such qualification in respect of the bye-laws.

(3) Amending regulations

5.22 The power to make and amend regulations is generally set out in the charity's Royal Charter or bye-laws. Privy Council approval is not normally required.<sup>250</sup>

## CRITICISMS OF THE CURRENT LAW

5.23 We summarised the criticisms of the current procedures for amendment in the Consultation Paper,<sup>251</sup> which were generally borne out by consultation. Criticisms by consultees fell into four broad, and overlapping, categories.

### (1) Unnecessary complexity, delay and costs

Royal Charter charities

5.24 Consultees said the process for amendment was complex and that there was a lack of transparency (on which see paragraph 5.34 below), which added to the costs of constitutional change since it occupies staff time and, very often, charities feel that they have to engage external lawyers to navigate the procedure. Those costs are increased further by the length of the process. In the Consultation Paper, we said that:

- (1) the express power procedure could take as little as six to eight weeks since the PCO aims to respond to enquiries and requests within 15 working days, but in some cases the reality is that the process can take up to one year, given the need to discuss and negotiate amendments with the various parties, many of which have infrequent meetings;<sup>252</sup>
- (2) the supplemental Charter procedure would normally take up to a year, but it can take up to two years; and
- (3) whilst the amendment of bye-laws can be a quicker process, it can nonetheless take a long time since the consent of the Privy Council is still usually required.

5.25 Keith Lawrey (an adviser) said that delays were not caused by the PCO, which is "remarkably efficient in seeking comments from its advisers", but by the delayed responses from the advisers themselves. He said that consultation with these advisers was important, and simply changing the organisation that requests their advice will not solve any problems. The PCO queried whether the perceived problems warranted statutory intervention since it deals with relatively few Charter amendments and supplemental Charters. It disagreed that there were delays in the process: "the only process 'delays' that we are aware of are as a result of a chartered charity proposing amendments that are perhaps inappropriate or unacceptable ... not as a consequence

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<sup>250</sup> See for example art 18 of the Royal Charter of the British Red Cross Society; para 65 of the bye-laws of the NSPCC; and para 43 of the bye-laws of the RNIB.

<sup>251</sup> Consultation Paper, paras 4.7 to 4.21.

<sup>252</sup> For example, the Privy Council meets nine times each year. Trustees may meet more frequently than this, but when an amendment requires a resolution of the charity's members, the resolution may have to await the charity's annual general meeting (or an extraordinary general meeting).

of the approval process”.<sup>253</sup> Some other consultees were content with the process. For example:

- (1) the Society for Radiological Protection said “the time and expense is not particularly excessive but it does take a long time in order to be thorough”; and
- (2) Imperial College London said its experience had been “positive” and the PCO had provided “helpful guidance and support”.

5.26 But there is undeniably dissatisfaction with the process amongst some Royal Charter charities. For example:

- (1) Cancer Research UK said that the process to amend the Charter and bye-laws of one of its predecessor charities, Imperial Cancer Research Fund, in order to simplify complex administrative provisions, was convoluted and time-consuming;
- (2) the Independent Schools Council reported that its member schools had found constitutional change to be “disproportionately complicated, time-consuming and expensive”;
- (3) the Royal Statistical Society has made recent minor changes and reported that it “took substantial staff time to engage with the Privy Council, including a six week wait for comments and then a response time after our Special General Meeting. Waiting on the Privy Council makes it difficult to predict when changes will take effect to allow for comprehensive planning”;
- (4) University College London said “the process is lengthy and challenging”, and that this had been “a deterrent to bringing forward re-organisational changes”;
- (5) Francesca Quint, a barrister, said “constitutional change for charities of these kinds is often put off because it is perceived as expensive, long-winded and complex or because non-specialist solicitors simply don't know how best to advise”;
- (6) Anthony Collins Solicitors LLP said that amendments for Royal Charter charities “are significantly more time-consuming and costly than for other charities, often disproportionately so”; and
- (7) Veale Wasbrough Vizards LLP described the supplemental Charter process as cumbersome, lengthy and costly.

5.27 The requirement for Royal Charter charities to pay to print supplemental Charters on vellum was also criticised by some consultees. It was seen as an inappropriate use of

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<sup>253</sup> The Institute of Directors said “The role played by the Privy Council seems to be largely misunderstood and a significant amount of folklore seems to have developed around their role and the perception has developed that they are blockers and stallers of progress when changing Charters and By-laws. We do not have evidence of this.”

charitable funds; one consultee described it as “an affectation and an unnecessary expense”.<sup>254</sup>

### Statutory charities

- 5.28 The section 73 procedure for statutory charities is complex and can take several years. The National Trust said the time taken to draft its section 73 scheme was proportionate and a helpful process, but that the Parliamentary process was “difficult to navigate and required us to instruct specialist parliamentary agents at a relatively high cost”.
- 5.29 Based on its recent experience, the National Churches Trust said the section 73 process was complex, expensive and time-consuming, taking 10 years to complete; “it is completely unreasonable to expect charities to incur this amount of staff time and mounting legal fees over a considerable period of years, when such resources could instead be put to the primary task of delivering the charity’s objects”. It therefore “fully [concurrent] with the expressions of frustration and complaint about the section 73 procedure”.
- 5.30 The RSPCA’s statutory governing documents have been the source of uncertainty and the subject of two High Court rulings. The RSPCA concluded: “Whilst such issues may be of great interest to lawyers, it makes the business of updating the charity’s constitution very complicated and costly which benefits neither the charity nor the wider public.”

## (2) Disproportionality

- 5.31 Consultees’ criticism of the complexity, delay and expense of the process was often based on the view that it was disproportionate for the Privy Council or Parliament to be involved in all amendments. As we said in the Consultation Paper in relation to Royal Charter charities, “the principal concern, it seems to us, is not with the level of service provided by the PCO, but rather as to whether the extent of their involvement is necessary, or could be limited to situations where their expertise and regulatory function would be more valuable”.<sup>255</sup>
- 5.32 Consultees offered mixed views about the service provided by the PCO, but were generally positive.<sup>256</sup> But even those who acknowledged the expertise and assistance provided by the PCO often maintained that the procedure was complicated, lengthy and bureaucratic. For both statutory and Royal Charter charities, the level of oversight is not tailored to the importance of the proposed amendment. One consultee said that PCO consultation with other public bodies takes time and was disproportionate when minor amendments are involved, particularly where the amendments simply “reflect good practice in other organisations”.<sup>257</sup>

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<sup>254</sup> Bates Wells Braithwaite. The cost of printing on vellum was also criticised by Veale Wasbrough Vizards LLP and Cancer Research UK.

<sup>255</sup> Consultation Paper, para 4.18.

<sup>256</sup> Some said that decision-making could be slow and inconsistent, and that the process sometimes became political. Others said that the PCO were contactable, responsive and helpful.

<sup>257</sup> Institute of Chartered Secretaries and Administrators.

- 5.33 Some consultees commented that there was something special about being a Royal Charter charity: there is respect for “the prestige and status of being a Royal Charter body and the cachet it brings”.<sup>258</sup> The PCO’s view is that, by accepting a Royal Charter and that special status, charities are agreeing to accept an additional level of governmental regulation:

New grants of Royal Charters are these days reserved for eminent professional bodies or charities which have a solid record of achievement and are financially sound. ... Both in the case of charities and professional bodies, incorporation by Charter should be in the public interest. This last consideration is important, since once incorporated by Royal Charter a body surrenders significant aspects of the control of its internal affairs to the Privy Council. Amendments to Charters can be made only with the agreement of The Queen in Council, and amendments to the body’s by-laws require the approval of the Council (though not normally of Her Majesty). This effectively means a significant degree of Government regulation of the affairs of the body, and the Privy Council will therefore wish to be satisfied that such regulation accords with public policy.<sup>259</sup>

### **(3) Lack of transparency in the amendment process**

- 5.34 There was a perception amongst consultees that the amendment process is shrouded in mystery. Bircham Dyson Bell LLP said that the amendment process for Royal Charter charities can be “frustrating, opaque and applied inconsistently”, that it can become political and that it was unclear how the Privy Council assesses the views of its advisers. The CLA reported the experience of those involved in the amendment of the British Council’s Charter in 2010 and 2011. Following consideration of the proposed changes both internally and with external advisers, a formal request for approval of the amendments was made to the PCO. Those involved “felt that the process of PCO approval was very opaque and hard for non-legal (or even legal but non-specialist) colleagues to understand. ... In general it was felt that the process could certainly be clearer and more transparent...”.<sup>260</sup>
- 5.35 The Institute of Chartered Secretaries and Administrators thought it would be helpful for the PCO to establish and publish “service level standards” which would “enable charities to better understand the timeframe for all types of dealings with the PCO”.
- 5.36 Similar criticisms were made of the process for statutory charities. Bircham Dyson Bell LLP said that the process can be drawn-out and can seem opaque, and that it discourages charities from making amendments.

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<sup>258</sup> Institute of Chartered Secretaries and Administrators.

<sup>259</sup> Privy Council, *Chartered bodies*, see n 248.

<sup>260</sup> The PCO point out that the process of amendment for the British Council, as a state-sponsored non-departmental public body, is likely to be different from other charities.

#### **(4) Inconsistencies**

5.37 In the Consultation Paper, we said that there were two inconsistencies in the amendment regimes.

- (1) The ease by which statutory charities can make an amendment might turn, by chance, on whether a section 73 scheme is already in operation in relation to the provision to be amended, since such a scheme can be amended without Parliamentary oversight.
- (2) Royal Charter charities can amend more easily if they have an express power of amendment, but face a longer, more complicated and more expensive process if they do not. And the ease of making an amendment will depend on whether the provision is contained in the Royal Charter, the bye-laws or the regulations, yet the same issue may be addressed in one charity's Charter, another's bye-laws and another's regulations.<sup>261</sup>

#### **Conclusion**

5.38 Whilst some consultees saw no difficulties with the process for constitutional change, most voiced some or all of the criticisms set out above. The consequence is that charities decide not to make amendments that ought to be made owing to "the daunting process of effecting change";<sup>262</sup> they are left with out-of-date governing documents and must find ways to work around the problem. The current position is unsatisfactory.

#### **OUR PROVISIONAL PROPOSALS**

5.39 We suggested three principal options for reform in the Consultation Paper. The first was self-standing. We presented the second and third as alternatives, though asked whether they might work together.

5.40 First, we noted that a Royal Charter charity whose Charter does not contain an express power of amendment will usually amend the Charter by using the supplemental Charter procedure, which takes longer and is more expensive. We noted that Royal Charters granted since the 1950s generally contain express amendment clauses. We provisionally proposed that any Royal Charter or bye-laws that do not contain an express amendment clause should be deemed to include a power for any provision to be amended, subject to any amendment being approved by the Privy Council.<sup>263</sup>

5.41 Second, we noted that when the PCO is approached by a Royal Charter charity seeking to amend its Charter or bye-laws, the PCO will often encourage the charity to use the opportunity to reallocate the different provisions of the charity's constitution between the Charter, bye-laws and regulations. Accordingly, if provisions concerning internal governance feature in the Charter, it may be appropriate to move them to the bye-laws so that they can be amended more easily in the future. Similarly, it may be appropriate for more minor provisions to be moved from bye-laws to regulations, so that they can be amended in the future by the trustees without Privy Council oversight. We endorsed

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<sup>261</sup> Consultation Paper, para 4.20.

<sup>262</sup> Francesca Quint. Similar comments were made by the CLA.

<sup>263</sup> Consultation Paper, para 4.24 to 4.32.

this re-allocation approach and asked consultees whether it could be facilitated by the PCO and Charity Commission issuing guidance concerning the types of provision that they would normally expect to see in a charity's Charter, bye-laws and regulations.

5.42 Third, we provisionally proposed that both statutory and Royal Charter charities should be given a power to make minor amendments to their governing documents without the oversight of Parliament or the Privy Council (as the case may be). We invited consultees' views as to the types of amendment that should fall within and outside the amendment power and asked further questions about how such a power would operate.

5.43 We also asked some supplemental questions about:

- (1) the role of the Charity Commission in making amendments to statutory and Royal Charter charities' governing documents;
- (2) whether section 73 schemes should always be subject to the negative procedure (rather than, in some cases, requiring the affirmative procedure);
- (3) the revision of PCO guidance concerning the amendment of bye-laws; and
- (4) whether it would be helpful for the various public bodies involved to issue joint guidance concerning the process for statutory and Royal Charter charities to make constitutional changes.

## DISCUSSION AND RECOMMENDATIONS FOR REFORM

### Royal Charter charities: improving the supplemental Charter procedure

Default amendment power exercisable with Privy Council consent

5.44 Charity advisers have told us that many Royal Charter charities do not have an express amendment power and that, given the time and expense involved under the supplemental Charter procedure, they often decide not to proceed with an amendment. They are therefore left with inconvenient, inappropriate and out-of-date governing documents.<sup>264</sup> Our provisional proposal for a default amendment power, to be exercisable with the consent of the Privy Council,<sup>265</sup> received unanimous support from consultees. It would create a "level playing field" between those (generally more recent) charities with an express power, and those (generally older) charities without such a power.<sup>266</sup> The PCO said it "could reduce the time taken to give effect [to] any proposed changes by removing the currently unavoidable need for a supplemental Charter".

*Should the power apply if there is an existing express amendment power?*

5.45 In the Consultation Paper, we said that the power should only apply to charities that do not already have an existing power of amendment. We said that existing powers of amendment may require certain conditions to be satisfied which are likely to have been carefully framed to suit the charity and which would be overridden if the default power operated in place of, or as an alternative to, existing amendment powers. We said that

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<sup>264</sup> Consultation Paper, para 4.12.

<sup>265</sup> See para 5.40.

<sup>266</sup> Anthony Collins Solicitors LLP.



the particular problem that we were seeking to address is the position of Royal Charter charities without any existing power of amendment who therefore have to use the supplemental Charter procedure, not charities that already have an express power of amendment and that can therefore already use the express power procedure.

- 5.46 Whilst most consultees agreed with us, some thought that the new amendment power should operate as an alternative to any express amendment powers, similarly to section 280 for unincorporated charities.<sup>267</sup> Stone King LLP said that our proposal would result in giving greater flexibility to a charity which previously had no power of amendment as compared to a charity with an existing (albeit more stringent) power of amendment. The CLA and Bircham Dyson Bell LLP agreed, though thought that any requirements for third party consent in any existing express amendment powers should continue to apply to the exercise of the new power.
- 5.47 We can see the strength of the argument for the new power to apply where there is an existing power, particularly as section 280 is currently available as an alternative to existing express amendment powers and we maintain that position in our recommendations above.<sup>268</sup> But we do not think that the new amendment power for Royal Charter charities should operate in the same way as section 280 for four reasons.
- (1) As noted above, the new amendment power is not intended to provide a universal amendment power; it is intended to put charities without an express amendment power (generally those whose Charter pre-dates the 1950s) in a similar position to charities with an express amendment power (generally those whose Charter post-dates the 1950s).
  - (2) The new amendment power is not the same as section 280. Section 280 allows the trustees to act alone without oversight. The new amendment power for Royal Charter charities would require Privy Council consent, in much the same way as express amendment powers. So for Royal Charter charities with express amendment powers, our proposed power is unlikely to give them very much more than they already have; both powers would require Privy Council consent to be operated. But permitting such charities to use both powers might have the disadvantage of circumventing the provisions in the existing tailored provision by replacing it with a universal power.
  - (3) There is a good argument for saying that section 280 should not be available to charities that have existing amendment powers.<sup>269</sup> But section 280 can already be used by such charities, so to limit section 280 to cases where there is no express amendment power would significantly curtail the existing powers of such charities. By contrast, Royal Charter charities do not currently have any similar default power, so limiting the new amendment power would not curtail the existing powers of Royal Charter charities.

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<sup>267</sup> See para 4.33.

<sup>268</sup> See para 4.77.

<sup>269</sup> Indeed, it is on the basis of this argument that our recommendations above for a new s 280A (see cl 3 of the draft Bill) respect third party rights under existing express amendment powers: see paras 4.81 to 4.88.

- (4) We explain below a theme from consultation responses that Royal Charter charities have a special status and that they are incredibly diverse, such that it is not possible to devise an appropriate list of provisions that would be appropriate for such charities to have freedom to amend without Privy Council oversight. Similarly, if Royal Charter charities have a tailored express amendment power, that should be respected. By comparison, consultees seemed comfortable that all charitable trusts and unincorporated associations were sufficiently similar that a universal amendment power (as under section 280) was appropriate.

5.48 We therefore remain of the view that the default amendment power for Royal Charter charities should only be available where the charity does not have an express amendment power.<sup>270</sup>

#### *Exercising the power*

5.49 In the Consultation Paper, we proposed that the power should be exercisable by a resolution of two-thirds of the charity trustees and, if the charity had a separate body of members, by a resolution of two-thirds of the members at a general meeting.<sup>271</sup> These majorities mirrored those required in many existing express amendment powers of Royal Charter charities.

5.50 The vast majority of consultees agreed that resolutions of the trustees and members should be required, although some suggested alternative majorities. The main alternative suggestion was for an ordinary resolution of the trustees and a resolution of 75% of the members, which was based on a desire for consistency with amendments by companies. We can see the benefits of aligning – so far as possible – the majorities required under an amendment power for Royal Charter charities with those required for companies and under our proposed new power for other charities (see paragraph 4.121 above). Having different majorities depending on the legal form of the charity makes it more expensive and time-consuming for charities using legal advice and increases the likelihood of (potentially costly) mistakes.

5.51 Consultees who disagreed with a requirement for a members' resolution generally did so for two reasons. First, they said it can be difficult to identify whether a Royal Charter charity has a membership. As we noted in relation to section 280,<sup>272</sup> the purpose of a members' resolution is to capture a charity with a body of members who have a role in the governance of the charity by virtue of an entitlement to vote on certain matters. It is not intended to capture charities that confer a membership status (for example, on previous students or on donors) where the members cannot easily be contacted and do not have a role in the governance of the charity. This first concern can therefore be addressed by requiring a members' resolution only when the charity has members with an entitlement to vote under the charity's governing document.

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<sup>270</sup> Prof Gareth Morgan pointed out, and we agree, that the power should apply where there is no express amendment power for the particular provision that the charity wishes to amend. So if an existing express amendment power permits changes to membership criteria (only), the new power should still be available in respect of other provisions.

<sup>271</sup> Consultation Paper, para 4.26.

<sup>272</sup> Para 4.110.

5.52 Second, there was a concern about the expense of obtaining a members' resolution, particularly given that the Privy Council might subsequently refuse consent to the amendment in which case the expense of obtaining the members' resolution will have been wasted. We think that this second concern can be addressed by permitting trustees to obtain an indication from the Privy Council as to whether the amendment would be approved before having to incur the expense of obtaining a members' resolution.

*Involving the Privy Council Office at an early stage*

5.53 Amendments under the new power would only take effect when they are approved. In order to avoid potentially wasted costs of putting a proposed amendment to a vote of the charity's membership, only for the amendment to be refused, the PCO have suggested to us that that charities should speak to them at an early stage. That will enable potential problems to be resolved, and the PCO to indicate approval in principle to the proposed amendment, before the resolution is put to a vote of the charity's membership. We agree, and the same applies whenever a charity wishes to amend its Charter or bye-laws under the existing routes. The PCO is keen to assist Charter bodies from an early stage in the process, and to ensure that amendments can be made as efficiently as possible. We would therefore encourage charities to engage with the PCO at an early stage, regardless of whether the proposed amendment can be made under the new statutory power or under existing routes for amendment.

*Should the power apply to bye-laws?*

5.54 In the Consultation Paper, we said the power should permit amendments to a Royal Charter and bye-laws, though we said it would rarely apply to bye-laws since they usually permit amendment with Privy Council consent.<sup>273</sup> The Cambridge Colleges said it was unnecessary for the new power to apply to the bye-laws since either:

- (1) the bye-laws will have been created *by* the Charter, in which case the new power to amend the Charter will also permit amendment of the bye-laws; or
- (2) the bye-laws will have been created *under* the Charter, in which case the new power can be used to amend the Charter so as to introduce a power to amend the bye-laws.<sup>274</sup>

5.55 We agree; the new power to amend the Charter could be used to amend any bye-laws for which there was no express amendment power.

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<sup>273</sup> Consultation Paper, para 4.27.

<sup>274</sup> The Colleges had a particular concern about the entitlement of third parties to amend the bye-laws, but that concern does not arise under our recommendation since the new power would only apply if there were no existing amendment power.

### **Recommendation 5.**

5.56 We recommend that:

- (1) a statutory power be created for Royal Charter charities to amend any provision in their Royal Charter which cannot be amended under any existing express power of amendment, subject to the amendment being approved by the Privy Council;
- (2) in the case of a charity that has a body of members with an entitlement to vote under the Royal Charter, the power should be exercisable:
  - (a) by a resolution of a majority of the trustees; and
  - (b) by a further resolution of those members which is passed:
    - (i) at a general meeting, by 75% of those members who attend and vote on the resolution;
    - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the meeting; or
    - (iii) otherwise than at a general meeting, unanimously;
- (3) in the case of a charity without a separate body of members, the power should be exercisable by a resolution of 75% of the trustees;
- (4) the trustees should be able to seek an indication from the Privy Council as to whether a proposed amendment would be approved before putting the resolution to a vote of the charity's members; and
- (5) amendments should take effect on the date on which the Privy Council consents to the amendment (or, if the resolution specifies a later date for it to take effect, on that date).

5.57 Clause 4 of the draft Bill would give effect to this recommendation.

Will the default amendment power solve the problems of using the supplemental Charter procedure?

5.58 The new statutory power that we recommend will remove the need for Royal Charter charities without an express amendment power to follow the supplemental Charter procedure. Such charities will not have to draft a supplemental Charter; the amendment can instead be made by an Order in Council, which can be far simpler and quicker. Moreover, such charities will not be subject to the requirements that petitions be publicised in the London Gazette and that Charters be printed on vellum.

5.59 But there will remain charities – with or without an express power of amendment – that want to effect an amendment by way of a supplemental Charter, for example, if the

charity is merging or undertaking a fundamental constitutional change that would be more easily achieved by “starting again”.

5.60 Moreover, the PCO’s response revealed that the new default amendment power would not always solve the problem of added costs and delay caused by the need for a supplemental Charter. The PCO suggested that only the numbered articles, and not the preamble paragraphs, of a Charter should be capable of amendment under the new power. “When a chartered body undergoes a significant change, such as a change of name or a merger with another body, the historical narrative in the preamble should be updated to reflect the change, and this is only achievable via the grant of a supplemental Charter”. We disagree that the new amendment power would be so limited. But there might still be circumstances in which the Privy Council would refuse to authorise an amendment under the new amendment power, or indeed under an express amendment power, which would leave the trustees in the position of having to obtain a supplemental Charter.

#### PCO practice

5.61 The main differences between the supplemental Charter procedure and the express power procedure are:

- (1) the requirement for the charity to pay for a supplemental Charter to be printed on vellum; and
- (2) the increased publicity requirements for supplemental Charters, namely publishing the petition in the London Gazette for eight weeks.

These are requirements imposed by the PCO as a matter of course.

#### *Publicity*

5.62 The PCO explained that the London Gazette remains the official record of Government matters, that the cost of publishing a petition by a charity in the Gazette is not borne by the charity, and that during the publicity period the petition is under active consideration by the Privy Council so the publicity requirement is unlikely to create an additional delay in the process. Nevertheless, we understand that, in practice, it is rare for the PCO to receive comments in response to publicity in the Gazette. Moreover, we think that the requirement is an added layer of “process” which can make the amendment procedure appear to be more complicated or take longer.

5.63 An automatic requirement for publicity is a rather blunt approach to a wide range of potential amendments. In cases where fundamental changes are proposed, it might be appropriate to publicise petitions. But in many cases, and certainly for minor changes, it will not be necessary to give public notice of the supplemental Charter (and if the charity had an express amendment clause, the Privy Council would not require any such publicity). By analogy, the Charity Commission has a discretion as to whether to publicise proposed schemes and it makes a decision based on whether it considers the scheme will be controversial.<sup>275</sup>

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<sup>275</sup> See para 4.47.



an appropriate use of their funds, they would not be prevented from voluntarily paying to have their Charter printed on vellum.

**Recommendation 6.**

5.69 We recommend that:

- (1) the Privy Council review its current policy of requiring all petitions by charities for Charters and for supplemental Charters to be publicised in the London Gazette for eight weeks with a view to removing, or replacing, that requirement; and
- (2) the Privy Council cease to require Charters or supplemental Charters granted to charities to be printed on vellum.

5.70 We are not aware of any legal requirement for the Privy Council to publish petitions for Charters in the London Gazette nor of any legal requirement for Charters to be printed on vellum. Our recommendation is therefore that the Privy Council revise its existing practices; as such, this recommendation does not require provision for its implementation in the draft Bill.

The end result

5.71 Following the implementation of our recommendations, it will be easier, quicker and cheaper to amend a Charter that does not contain an express power of amendment. Moreover, where – for any reason – a supplemental Charter is needed to effect an amendment, the process will be quicker and cheaper.

**Statutory and Royal Charter charities: power to make minor amendments and guidance**

5.72 We proposed that statutory and Royal Charter charities be given a power to make minor amendments to their governing documents without Parliamentary or Privy Council oversight. We noted the counter-arguments; principally that such charities might have a special status that is preserved by the state's control over amendments. But we said that the legal form of a charity can sometimes be no more than a historical accident and that there is no reason for statutory and Royal Charter charities to face a higher degree of regulation and protection than other charities. We argued that trustees can be trusted and that if a charity's governing document prevents it from pursuing its purposes in the best way possible then its work is hampered.<sup>281</sup> We suggested the types of amendment that could fall within, and outside, an amendment power and invited consultees' views.<sup>282</sup>

Support for a minor amendment power

5.73 Most consultees agreed, at least in principle, that charities should be given a power to make constitutional amendments without Parliamentary or Privy Council oversight. It

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<sup>281</sup> Consultation Paper, paras 4.40 to 4.44.

<sup>282</sup> Consultation Paper, paras 4.46 to 4.55.

would help address the criticisms of the current law set out above and “would help institutions avoid having inconvenient, inappropriate and out-of-date governing documents”.<sup>283</sup> Opinions differed on the range of matters that should fall within the power. Some consultees thought that the power should apply to any provision save for regulated alterations;<sup>284</sup> others thought that the power should be more limited.

#### Concerns about a minor amendment power

5.74 There were two principal concerns about our provisional proposal to confer a power on charities to make minor amendments to their governing document.<sup>285</sup>

5.75 First, some consultees expressed a constitutional concern about the propriety of charities and trustees, by resolution, making changes to primary legislation or a Royal Charter without oversight and without the approval of Parliament or the Privy Council. The PCO said it would be “a fairly major constitutional shift”. We accept that creating such a power for any charity governed by a Royal Charter or statute (as opposed to named charities) could be controversial, but we do not believe that it is insurmountable.

5.76 Second, several consultees commented on the particularly diverse range of Royal Charter and statutory charities.<sup>286</sup> Stone King LLP said that Royal Charter charities range from:

charities set up centuries ago, which might not be set up in the same way today given the range of options now available, through to Royal Charter bodies set up in the last few years, where there has been an active decision to choose a Royal Charter ‘vehicle’ with the ability to regulate it more tightly.

That led some consultees to raise a practical concern about whether it would be possible to devise a suitable list or category of provisions that would always be sufficiently uncontroversial so as to be appropriate for trustees to amend without the consent of Parliament or the Privy Council.

5.77 The PCO said that provisions that are minor for benevolent institutions would not be minor for professional and management institutions. For example, membership criteria can include permission to use various levels of chartered membership or chartered designations. The PCO explained that its “oversight of membership criteria and levels, and the power to use titles and post nominal descriptors must be retained to ensure stability and parity within the chartered professional title area.”

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<sup>283</sup> Association of the Heads of University Administration.

<sup>284</sup> See para 4.5 above.

<sup>285</sup> There were two further concerns. The PCO said the power “could be misused, difficult to monitor, and consideration would need to be given as to the effect on an amendment made under this power if the power were misused or used unlawfully and a successful challenge brought ... Surely the current method ... safeguards against poor decisions which will be costly to rectify?” In addition, some consultees noted that the creation of such a power would create inconsistencies with other Charter bodies (which would not have such a power), and inconsistencies between charities in England and Wales as compared with charities in Scotland and Northern Ireland (to which our recommendations would not apply).

<sup>286</sup> Stone King LLP; the Cambridge Colleges; PCO; University of Birmingham; Institute of Chartered Secretaries and Administrators; Bates Wells Braithwaite; Charity Law and Policy Unit (University of Liverpool); the CLA; Bircham Dyson Bell LLP; and Independent Schools Council.



- 5.78 The Independent Schools Council gave the example of independent schools with a religious designation for whom a change to the criteria for trustees' religious beliefs would likely be a significant change.
- 5.79 Similarly, the CLA and Bircham Dyson Bell LLP did not think that it would be feasible to define "minor amendments" for all statutory or Royal Charter charities.<sup>287</sup> The CLA said that "for some charities it would be difficult to find any amendment which would be considered "minor" for that charity's constitution ... Ostensibly minor amendments ... could potentially have far-reaching consequences."
- 5.80 In short, as the Charity Law and Policy Unit (University of Liverpool) said, "one size may not fit all". It is noteworthy that, in response to our question about the types of provision that should fall outside the new power, consultees gave numerous and varied types of provision for which they thought that amendment without oversight would be inappropriate, which tends to reinforce the view that one size does not fit all.
- 5.81 We accept these practical concerns about the diverse range of statutory and Royal Charter charities. In response, it might be possible to limit a new amendment power to the most minor provisions. For example, changing the month in which a charity's annual general meeting must be held is extremely unlikely to be controversial for any statutory or Royal Charter charity. But the more limited the power, the less likely it is to be useful since more amendments would have to be effected by existing means. A very limited power would also fare poorly under a cost-benefit analysis, since the significant effort required to devise the power and to overcome the constitutional sensitivities would not be justified by the limited utility that the amendment power would provide in practice.
- 5.82 An alternative response to consultees' practical concerns would be to confine the amendment power to certain charities. We acknowledge that there are different types of statutory and Royal Charter charity; the General Medical Council is a very different organisation from the National Trust (both of which are statutory charities), and the Royal College of Anaesthetists<sup>288</sup> is a very different organisation from the Royal Society for the Protection of Birds (both of which are Royal Charter charities). The PCO distinguished between Charter charities that are benevolent institutions and those that are professional or management institutions. It might be possible to devise a suitable list of provisions to fall within an amendment power for benevolent institutions (as the PCO called them), but it would be difficult to devise a clear definition of benevolent institutions and we are reluctant to create a new statutory categorisation of charities along these lines. In any event, in the light of consultees' comments set out above, we are not convinced that it would be possible to devise a list of minor amendments that

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<sup>287</sup> They did not support a regime that set out a list of permitted alterations because (1) it would be almost impossible to devise an appropriate list, and (2) it would rarely, if ever, be updated, even if there was a power to update it by secondary legislation.

<sup>288</sup> The Royal College of Anaesthetists "is the professional body responsible for the specialty of anaesthesia throughout the United Kingdom. Its principal responsibility is to ensure the quality of patient care through the maintenance of standards in anaesthesia, pain medicine and intensive care. The College's activities include: setting standards of clinical care; establishing the standards for the training of anaesthetists and those practising critical care and/or acute and chronic pain medicine; setting and running examinations; and continued medical education of all practising anaesthetists": see <http://www.rcoa.ac.uk/about-the-college/structure-organisation-and-regulations>.

would be suitable for all benevolent institutions, whilst still being sufficiently wide so as to be useful in practice.

5.83 In response to doubts about the possibility of devising an appropriate list of minor amendments, the CLA and Bircham Dyson Bell LLP suggested a different statutory procedure for making amendments. They thought that Royal Charter charities could pass resolutions proposing any amendments (save for regulated alterations) which would then be submitted to the PCO. The PCO would have three months to consider and, if appropriate, object to resolutions, failing which the amendments would take effect.<sup>289</sup> They suggested that officials in the PCO could make approval decisions to speed up the process, just as officials at the Charity Commission make decisions on its behalf. The CLA also suggested a similar process for statutory charities, under which Parliament would have a set period to object to a proposed amendment. It seems to us that the CLA's proposal, in effect, retains a similar level of oversight but codifies and simplifies the process with the addition of a deadline.<sup>290</sup> We regard the CLA's proposal, at root, as a plea for transparency in the process and certainty as to the timescales, which – as we discuss below – we think can be achieved more easily by improving the process (and guidance as to how to navigate the process), than by codifying a procedure in statute.

5.84 The attraction of the CLA's proposal, however, is that it is intended to improve the process generally for *all* constitutional amendments by *all* statutory and Royal Charter charities, rather than focussing on a limited range of constitutional amendments or a limited class of statutory and Royal Charter charities. But we think that such an improvement to the process can be achieved in the alternative way that we discussed in the Consultation Paper, namely:

- (1) encouraging the re-allocation of provisions within governing documents so that future amendment can be carried out with appropriate oversight;<sup>291</sup> and
- (2) providing guidance both about such re-allocation and about the amendment procedures.

5.85 In the Consultation Paper, we said that that there was a link between the creation of a minor amendment power and encouraging re-allocation. The wider the amendment power, the less need there would be to re-allocate provisions, and conversely the narrower the amendment power, the more need there would be to re-allocate provisions.<sup>292</sup> Some consultees noted that re-allocation would still take place even if the minor amendment power was wide.<sup>293</sup> A minor amendment power would not be a

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<sup>289</sup> Such a deemed consent process would be similar to that under the Charities Act 2011, s 275 (which we recommend repealing in Ch 4) and under s 282 (which we recommend retaining in Ch 8) below.

<sup>290</sup> In the case of Royal Charter charities, it would avoid the need for an Order in Council (made at one of the nine Privy Council meetings each year) or an Order of Council (made by the Privy Councillors otherwise than at a meeting) confirming the amendment, but the Privy Council's consent would still be required. In the case of statutory charities, there is already a statutory procedure in s 73, but the CLA's proposal would avoid some of the steps that are currently required: see Figure 6 above.

<sup>291</sup> See para 5.41 above.

<sup>292</sup> See Consultation Paper para 4.71.

<sup>293</sup> Plymouth University; Stone King LLP; Anthony Collins Solicitors LLP; University College London.

complete solution to the difficulties faced by Royal Charter charities in respect of all constitutional amendments, so facilitating re-allocation and providing guidance would still be helpful.

- 5.86 In the Consultation Paper, we endorsed the re-allocation approach for Royal Charter charities and said that it could be used to greater effect by the PCO and Charity Commission issuing guidance concerning the types of provision that would normally appear in a Charter, bye-laws and regulations.<sup>294</sup> A minority of consultees expressed their preference for the re-allocation approach over the proposal for a minor amendment power: “an initial amendment could establish, for the Royal Charter charity concerned, the appropriate demarcation between minor and non-minor amendments”.<sup>295</sup>
- 5.87 Despite the fact that the majority of consultees supported (at least in principle) a minor amendment power, we are not recommending its introduction. That is because we agree with the concerns of those consultees who thought that it would be practically difficult to identify categories of provision that were in all cases suitable for amendment without oversight, or that such categories would be so limited as to rob the amendment power of any practical utility. We have concluded that a power for statutory and Royal Charter charities to make minor amendments to their governing documents should not be introduced, but that instead re-allocation of provisions should be encouraged and facilitated, and that the process for amendment should be easier to navigate. We now turn to consider how re-allocation works, the means by which it could be encouraged, and improvements to the existing processes.

#### Re-allocation of provisions

- 5.88 Since amendments to both the Charter and bye-laws of a Royal Charter charity require Privy Council consent,<sup>296</sup> moving provisions from the Charter to the bye-laws does not have a great benefit.<sup>297</sup> The principal benefits of re-allocation are therefore felt by moving provisions from the Charter or the bye-laws (amendment of which requires Privy Council consent)<sup>298</sup> to the regulations.
- 5.89 The re-allocation approach can also be used, in a slightly different way, by statutory charities. Statutory charities could obtain a section 73 scheme that removed provisions from Parliamentary oversight by providing that the charity is permitted to issue regulations concerning certain matters without Parliamentary oversight of their content. An alternative, adopted by the National Trust in its section 73 scheme, is to include an express power to amend the scheme, subject to certain procedural requirements but without requiring Parliamentary oversight.<sup>299</sup>
- 5.90 Re-allocation might require a significant overhaul of a charity’s governing documents, or it might be done on a smaller scale in respect of a few provisions when a charity

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<sup>294</sup> Consultation Paper, para 5.21.

<sup>295</sup> The Cambridge Colleges. The PCO made similar comments.

<sup>296</sup> Subject to para 5.21 above.

<sup>297</sup> There is some benefit since generally Charter amendments must be approved at a Privy Council meeting whereas bye-law amendments do not require a meeting.

<sup>298</sup> Subject to para 5.21 above.

<sup>299</sup> Charities (National Trust) Order 2005 SI 2005 No 712, Appendix, para 45.

wishes to make an ad hoc amendment to its governing document. Following consultation, we have concluded that a re-allocation approach would be assisted, first, by guidance as to how the amendment process works, and second, by guidance as to how provisions should be allocated in governing documents.

- 5.91 But not all charities wishing to amend their governing documents will wish to re-allocate provisions; they might be content with the general structure of their governance, and for Parliament or the Privy Council to have oversight of amendments, but nevertheless wish to make changes to certain provisions. Following consultation, we have concluded that the first category of guidance, concerning how the amendment process works, would be of great assistance to such charities.

#### Guidance to facilitate re-allocation and amendment of governing documents

- 5.92 We asked consultees about both categories of guidance, the first being concerned with the process of amendment, the second with the substance of those amendments. As for the first category, the PCO already provides some guidance for Royal Charter charities. Some consultees said that it was helpful; others said that it could be improved. There is no guidance for statutory charities. The second category of guidance concerns the distribution of provisions between different parts of the charity's governing documents,<sup>300</sup> and therefore questions of good governance.

- 5.93 Most consultees thought that both categories of guidance would be helpful, though some thought that the first category was a higher priority.

#### Guidance concerning the process of amendment

- 5.94 There was strong support from consultees for the first category of guidance. Consultees commented that guidance would be helpful and provide transparency. It can also make clear the extent to which different bodies are involved in the process<sup>301</sup> and ensure a consistent approach between the various public bodies involved.<sup>302</sup> Consultees said that the current guidance is "very limited"<sup>303</sup> and that the PCO's guidance "leads charity trustees to believe that it is procedurally very complicated and it could potentially put trustees off pursuing amendments".<sup>304</sup> Veale Wasbrough Vizards LLP said it would be helpful to have flowcharts indicating the likely timescales for the different steps as well as template documents. The CLA wanted the guidance to set out the preliminary steps that charities should take as well as specifying the process for consultation with other bodies so that the process is understood, consistent and avoids becoming politicised. Bates Wells Braithwaite said that for section 73 schemes, it would be useful to have guidance concerning whether, and if so when, an impact assessment will be required.

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<sup>300</sup> For Charter charities, whether provisions should be in the Charter, bye-laws and regulations, and for statutory charities, whether provisions should require Parliamentary oversight before they are amended.

<sup>301</sup> University of Durham; Imperial College London; and Cancer Research UK.

<sup>302</sup> Institute of Chartered Secretaries and Administrators; Society for Radiological Protection. Anthony Collins Solicitors LLP said that the interplay between the Privy Council and Charity Commission "can be rather disjointed" and that "finding ways of operationally improving the interplay would be helpful".

<sup>303</sup> Anthony Collins Solicitors LLP.

<sup>304</sup> Stone King LLP.

5.95 We think that guidance on the process of amendment will go a long way to solving the lack of transparency reported by consultees. Francesca Quint commented, for example, that the process is “perceived as expensive, long-winded and complex” and that “non-specialist solicitors simply don't know how best to advise”. Transparent guidance would be likely to:

- (1) overcome misconceptions about the process;
- (2) ensure a consistency of approach by each body involved, and between the different bodies involved; and
- (3) assist both charities and their advisers in working out the best way to proceed, the steps that they need to take, and the likely timetable.

#### *Royal Charter charities*

5.96 For Royal Charter charities, we think that such guidance should be published by the PCO, with input from the Charity Commission and DCMS. We think that the guidance should:

- (1) encourage charities to contact the PCO at an early stage in order to seek advice and assistance in respect of proposed amendments;
- (2) explain the role of the different bodies involved;
- (3) explain the preliminary steps that should be taken;
- (4) include template or sample documents, where possible; and
- (5) include information about the approval process itself, such as:
  - (a) the difference between amendment by way of a supplemental Charter and amendment pursuant to an express power;
  - (b) the distinction between an Order in Council (approval at a Privy Council meeting) and an Order of Council (approval of Privy Councillors);
  - (c) the basis on which – and process by which – the PCO will consult with other bodies;
  - (d) the likely timescales; and
  - (e) the dates of the forthcoming Privy Council meetings (and the point at which a charity's proposed amendments would need to be submitted to the PCO in order to be considered at those meetings).

#### *Statutory charities*

5.97 For statutory charities, in principle we think that the guidance should be issued jointly by the Charity Commission, DCMS and Parliament, since all are involved in the process. We suspect that, in reality, such guidance would more easily be produced by the Charity Commission and DCMS, which would be satisfactory since Parliament's involvement is at the very end of the process and both the Charity Commission and DCMS assist

statutory charities to navigate the Parliamentary process under a section 73 scheme. We think that the guidance should:

- (1) explain the role of the different bodies involved;
- (2) explain the preliminary steps that should be taken, including when an impact assessment will be required; and
- (3) include information about the approval process itself (on which, see Figure 6 above), including the likely timescales.

Guidance concerning the substance of amendments

#### *Royal Charter charities*

5.98 Consultees thought that the second category of guidance would particularly assist Charter charities that were looking to overhaul their governing documents. It was suggested that it would help to facilitate a more standardised approach to the governing documents of Charter bodies, though other consultees saw a risk of guidance reducing flexibility by being treated as prescriptive. The PCO thought that guidance from the Charity Commission covering benevolent institutions might be appropriate, but thought it would be “difficult to provide general guidance of any real practical use” for the wide range of remaining bodies. Some consultees commented that any guidance that catered for that variety of bodies would become confusing or unwieldy,<sup>305</sup> though some universities suggested sector-specific guidance which might solve the problem.<sup>306</sup>

5.99 We rejected a universal minor amendment power owing to the diverse range of statutory and Royal Charter charities. We accept that, for the same reasons, it would not be possible to provide rigid guidance as to the appropriate allocation of different provisions in such charities’ governing documents. But guidance permits flexibility; it can set out general principles yet proposed amendments would still be considered on a case-by-case basis. Further, guidance can set out broad categorisations of different statutory and Royal Charter charities (for example, benevolent institutions, professional membership bodies, regulatory bodies), for whom the appropriate allocation of provisions will differ. It would be possible to look at some sample Charters, bye-laws and regulations and extract any themes that emerge – for example, provisions concerning the charity’s purposes, powers and board structure might generally appear in the Charter; provisions concerning the election of trustees might generally appear in bye-laws; and provisions concerning the procedure for meetings might generally appear in regulations.

5.100 We are encouraged that the PCO thought that guidance on reallocation could be provided for Royal Charter charities that are benevolent institutions. We suspect that such guidance would reflect the distinction for the more common forms of charities (see Chapter 4) between provisions that do, and do not, require Charity Commission oversight. For example, provisions that would be regulated alterations (for companies

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<sup>305</sup> University of Birmingham; and Institute of Chartered Secretaries and Administrators.

<sup>306</sup> University College London; Imperial College London; and University of Durham. Pinsent Masons LLP made similar comments.

or CIOs) should appear in the Charter or bye-laws, whilst other provisions might appear in the regulations to permit future amendment without oversight.

5.101 For other types of Royal Charter charity, the guidance can set out the matters that will generally be of public interest and therefore require Privy Council approval, such as the different membership categories for a professional membership body, and the disciplinary procedures for a regulatory body. We consider guidance for higher education institutions separately below.<sup>307</sup> The PCO and Charity Commission could seek input from appropriate governance experts in drafting such guidance. It might be that a sector working group could be established to assist with the preparation of such guidance, to draw on existing experience, expertise and good practice concerning appropriate oversight of constitutional amendments. A similar sector-led group has recently published a new Charities Governance Code.<sup>308</sup>

### *Statutory charities*

5.102 We noted above that a re-allocation process was slightly different for statutory charities, but would still involve removing certain provisions from Parliamentary control. It is difficult to expect Parliament to issue guidance about the sorts of provision that ought to remain subject to Parliamentary control. We expect that Parliament would be guided by the expertise of the Charity Commission in approving appropriate governance arrangements when it prepares a section 73 scheme. We think that it would be helpful for the Charity Commission, in conjunction with DCMS, to publish guidance concerning the matters that it considers are generally suitable for Parliamentary control for different types of statutory charity (perhaps reflecting the guidance for Royal Charter charities). Parliament would not be bound by such guidance since it, rather than the Charity Commission, is the final decision-maker on constitutional amendments by statutory charities. But we would expect good practice guidance from the Charity Commission to carry weight when Parliament considers section 73 schemes.

### *Model governing documents*

5.103 As part of guidance on the appropriate allocation of provisions in governing documents, the PCO, Charity Commission and DCMS could produce simple model governing documents for statutory and Royal Charter charities to be used as a basis for constitutional change. The Charity Commission and PCO have suggested difficulties with this approach since (as we have discussed above) statutory and Royal Charter charities are so diverse, so it would not be possible to devise a single section 73 scheme or a single Charter that would be appropriate for all such charities. But a basic model (or different models) could be produced, or reference might be made to the governing documents of existing statutory and Royal Charter charities (where these are available) which could be used as a point of reference.

### *Conclusion*

5.104 It is important that constitutional change for statutory and Royal Charter charities is made as easy as possible. It should not be difficult, for example, to change the date of a charity's annual general meeting or allow a charity to send its accounts to members

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<sup>307</sup> See para 5.123 and following below.

<sup>308</sup> See <https://www.charitygovernancecode.org/en>.

by email rather than by post.<sup>309</sup> Rather than introducing a minor amendment power to permit such changes to be made, we have concluded that the best way to improve charities' ability to carry out constitutional change is:

- (1) (for Royal Charter charities) by both avoiding the need for supplemental Charters and also improving the process for obtaining a supplemental Charter where it remains necessary;
- (2) (for both statutory and Royal Charter charities) by charities overhauling their governing documents so as to permit the future amendment of certain matters without the consent of Parliament or the Privy Council;
- (3) (for both statutory and Royal Charter charities) by the provision of clear and accessible guidance concerning the process by which amendments can be made; and
- (4) by the provision of flexible guidance (for Royal Charter charities) concerning the allocation of provisions between the Charter, bye-laws and regulations and (for statutory charities) concerning the matters that should generally remain subject to Parliamentary control.

5.105 We hope that, with improved guidance and transparency, constitutional change will be easier and trustees will be less reluctant to engage the process.

#### Existing PCO guidance

5.106 We noted above that the PCO's guidance currently suggests that the amendment of bye-laws always requires consent, whereas some bye-laws can be amended without consent.<sup>310</sup> In the Consultation Paper, we proposed that the guidance be changed to reflect this point. No consultee disagreed. The PCO said that it was happy to clarify its guidance, but added "only a handful of Charters (about 1-5%) are, in fact, silent on the matter of amendment, so we do question the value added". We consider that there is clear benefit in guidance being accurate, even if the benefit is only felt by a small number of Charter charities. Our recommendation would require the guidance to say that charities must comply with any conditions in the Charter concerning the amendment of bye-laws, which will generally require the Privy Council's consent.

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<sup>309</sup> These are examples of recent changes given by the Royal Statistical Society and the Royal Archaeological Institute.

<sup>310</sup> Para 5.21 above.



### **Recommendation 7.**

5.107 We recommend that:

- (1) in order to improve the process by which charities can make constitutional amendments:
  - (a) the Privy Council Office, in consultation with the Charity Commission and DCMS, produce guidance concerning the process by which Royal Charter charities can amend their governing documents;
  - (b) the Charity Commission and DCMS produce guidance concerning the process by which statutory charities can amend their governing documents;
- (2) in order to facilitate the re-allocation of provisions within governing documents:
  - (a) the Privy Council Office, in consultation with the Charity Commission and DCMS, produce guidance for Royal Charter charities concerning the types of provisions that should generally appear in the Royal Charter, the bye-laws or the regulations;
  - (b) the Charity Commission, in consultation with DCMS, produce guidance for different statutory charities concerning the types of provision that should generally be subject to Parliamentary control; and
- (3) the PCO amend its guidance to make clear that amendments to bye-laws only require approval when that is expressly required by the Royal Charter itself.

5.108 We discuss below the provision of similar guidance for higher education institutions which are governed by Royal Charter or by statute.<sup>311</sup> That tailored guidance for higher education institutions should, so far as possible, be consistent with the guidance that we recommend for all Royal Charter and statutory charities above.

### **Other improvements to the amendment process**

5.109 We have already recommended that the PCO stops requiring supplemental Charters to be printed on vellum and that they remove or reduce the publicity requirements for a supplemental Charter. We have further recommended that guidance be produced to assist charities both in overhauling their governing documents and navigating the amendment process. We now turn to consider other suggestions made by consultees to improve the amendment processes.

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<sup>311</sup> Responsibility for the preparation of that guidance would fall (in England) to the Department for Education and/or the new Office for Students, and (in Wales) to the Welsh Government or another appropriate public body: see para 5.123 and following.

## Royal Charter charities

- 5.110 Consultees made various suggestions of ways in which the PCO could make its processes quicker and easier to navigate. We noted above the suggestion that the Privy Council publish service standards, and the suggestion that it provide template documents. Similarly, Stone King LLP suggested that the PCO provide online forms for charities to seek consent to amendments.
- 5.111 University College London suggested the introduction of a “fast-track approval procedure” under which charities could show that their proposed changes fell entirely within matters covered by guidance, or permitted amendments, and the Privy Council could then agree to approve the changes without going through the process of consulting with stakeholders. In a similar vein, the CLA suggested that PCO officials could give approval to certain amendments without having to await formal consent from Privy Councillors or at a meeting of the Privy Council.
- 5.112 Bates Wells Braithwaite suggested that the Privy Council’s requirements for the drafting of resolutions to make changes be relaxed as they can cause considerable costs. They said that the Privy Council had recently “been very helpful in allowing us to show replacement provisions in a schedule to the resolution, which is much quicker”.
- 5.113 These suggestions by consultees concern PCO practices, rather than a need for law reform. Therefore, we have not reached any conclusion as to the desirability or practicality of any of the specific suggestions that were made to us. We think, however, that these, and other, improvements to the PCO’s procedures warrant further discussion both by the PCO and those charities and advisers who engage with the PCO in making constitutional amendments. It seems to us that the best and most practical way to monitor and improve the current procedures is for the creation of a user group with representatives from the PCO, charities and their advisers, and perhaps other non-charitable Chartered bodies, which can discuss improvements which the PCO can then implement.

### **Recommendation 8.**

- 5.114 We recommend that the Privy Council Office establish a user group to allow those who engage with the process of amending Charters and bye-laws to propose and discuss improvements to the procedures.

## Statutory charities

### *The alternative affirmative and negative procedures in section 73*

- 5.115 In the Consultation Paper, we proposed that all section 73 schemes should be subject to the negative procedure, rather than distinguishing between section 73 schemes in respect of private Acts (which follow the negative procedure) and schemes in respect of public general Acts (which follow the affirmative procedure).<sup>312</sup> All consultees who answered this question agreed; the CLA thought that the negative procedure provided

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<sup>312</sup> Consultation Paper, paras 4.82-4.84 and 4.89.

sufficient Parliamentary oversight. The National Churches Trust, which had recent experience of obtaining a section 73 scheme through the affirmative procedure said:

The parliamentary process (involving the affirmative procedure) included work by the NCT on briefing ministers in both Houses of Parliament, including advising on their speeches and answers to likely questions, and liaising with opposition frontbenchers. We were able to deal with this effectively but this might be a challenge for some small charities not used to dealing with Parliament and its technical procedures.

5.116 We recommend that all section 73 schemes should be subject to the negative procedure. Charities founded by public general Act are not necessarily more well-known, or larger, than charities founded by private Acts. The National Trust, for example, was founded by a private Act, the amendment of which is subject to the negative procedure. The Incorporated Church Building Society, by contrast, is perhaps less well known than the National Trust but was incorporated by a public general Act such that amendments are subject to the affirmative procedure. We do not think that the mere fact that a statutory charity is governed by a public general Act, rather than a private Act, justifies a greater degree of scrutiny in respect of amendments.

5.117 Moreover, the very existence of the distinction means that consideration must be given to which procedure applies, which can take additional time or result in further expense if advice is sought on the issue.<sup>313</sup> For consistency, we think that there should be a single procedure for amendment, regardless of whether the Act that is being amended is a public general Act or private Act. In our view, that single procedure should be the negative procedure. First, the negative procedure is already followed in respect of the majority of section 73 amendments as most statutory charities are governed by a private Act. Second, there are significant constraints on Parliamentary time, yet the affirmative procedure requires Parliamentary time for a debate and resolution from both Houses of Parliament. The amendment process under the affirmative procedure can therefore be more time-consuming and prone to failure than under the negative procedure. Third, we consider that the negative procedure provides a sufficient degree of Parliamentary oversight for amendments to statutory charities' governing documents.

#### **Recommendation 9.**

5.118 We recommend that all section 73 schemes be subject to the negative procedure, regardless of whether the governing document is contained in a private Act or a public general Act.

5.119 Clause 5 of the draft Bill would give effect to this recommendation.

#### *Other procedural improvements*

5.120 The procedure in section 73 itself is fairly straightforward. Broadly speaking, the process involves two steps: a scheme is drafted that would change the effect of the charity's

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<sup>313</sup> We have heard that there was uncertainty as to whether the Church Building Society Act 1828, governing the Incorporated Church Building Society, was a public general Act, which delayed the process of making the amending scheme under s 73.

governing document, and the scheme is then given effect by an order which is subject to the negative or affirmative procedure. But as a matter of practice there are various additional steps: see Figure 6. It would be helpful for DCMS, the Charity Commission and the Parliamentary authorities to review their existing procedural requirements, with a view to reducing and simplifying them. That does not require law reform since the requirements in section 73 do not prescribe the detailed procedural requirements set out in Figure 6.

5.121 In addition, it might be possible for the Charity Commission and DCMS to offer and promote amongst statutory charities a single section 73 order (and therefore a single Parliamentary process) that would implement schemes for multiple statutory charities (“a collective section 73 order”). As statutory charities are so diverse, we do not think that it would be possible to have a single scheme that applies to all charities that take part in a collective section 73 order; rather, each scheme would have to be unique for each particular charity.

5.122 A collective section 73 order along these lines would provide economies of scale for the second stage of the process (namely giving effect to schemes by an order), since some steps would not have to be taken for each individual charity. A collective section 73 scheme is already possible so does not require law reform. It is a possibility that charities and their representatives could discuss with the Charity Commission and DCMS.

## **HIGHER EDUCATION INSTITUTIONS**

5.123 In the Consultation Paper, we asked for views as to how a new minor amendment power should apply to higher education institutions (“HEIs”), many of which are statutory or Royal Charter charities. Since the close of consultation, there has been significant reform in respect of English HEIs as a result of the Higher Education and Research Act 2017 (“HERA”). The relevant provisions of the HERA are not yet in force, and nor do they extend to Wales. We explain the provisions below, but we also explain the current law, which will continue to apply to Welsh HEI’s when the provisions of the HERA are brought into force.

### **Constitutional change: the current law**

5.124 The procedures by which HEIs can undertake constitutional change depends on how they are governed, although the Privy Council is always involved in the process. There are four broad categories.

(1) Universities governed by Royal Charter

5.125 Some universities are incorporated by Royal Charter. Amendments to their Charter and bye-laws (referred to in this context as their statutes) require the Privy Council’s consent in the usual way.

(2) Universities governed by Act of Parliament

5.126 Other universities, which may or may not be established by Royal Charter, are governed by individual Acts of Parliament which set out the procedure for the amendment of the

university's statutes.<sup>314</sup> The procedure is different under each Act, but amendments always require the consent of the Privy Council.

### (3) Higher education corporations under the Education Reform Act 1988

5.127 Higher education corporations ("HECs") are bodies corporate established under section 122 of the Education Reform Act 1988 ("the 1988 Act")<sup>315</sup> for the purpose of providing higher education services. An HEC's constitution comprises three documents.

- (1) Its "instrument of government", prepared by way of an order of the Privy Council.<sup>316</sup> Schedule 7A to the 1988 Act sets out the matters for which provision must be made and those for which provision may be made. The instrument of government can be amended only by an order of the Privy Council.<sup>317</sup>
- (2) Its "articles of government", prepared by the HEC itself and approved by the Privy Council. The matters to be addressed in the articles of government are set out in section 125 of the 1988 Act. The articles may be varied or revoked by the HEC with the approval of the Privy Council.<sup>318</sup>
- (3) Its rules and bye-laws, which the articles empower the HEC to make and which are not subject to Privy Council consent.

### (4) Designated institutions under the Education Reform Act 1988

5.128 A few higher education institutions are structured as companies or trusts and are "designated institutions" under section 129 of the 1988 Act. There are broad requirements for the contents of their governing documents (to be called the instrument and articles of government, as with HECs).<sup>319</sup> Such bodies have the same powers to amend their governing documents as other companies and trusts, but by reason of being designated under the 1988 Act they must obtain the Privy Council's consent to any such amendment.<sup>320</sup>

## Re-allocation of provisions

5.129 In 2006, the Westminster Government wrote to the Vice Chancellors of English universities, and the Welsh Government wrote to the Vice Chancellors of Welsh universities, setting out the categories of provision that they considered did, and did not,

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<sup>314</sup> See Consultation Paper, Figure 7 (pp 60-61).

<sup>315</sup> As amended by the Further and Higher Education Act 1992. Strictly speaking, the 1988 Act, s 122 does not itself create an HEC; rather, it confers on the Secretary of State a power to make an order establishing an HEC: 1988 Act, s 122(1) and (6). However it is usual to refer to an HEC as being established under s 122: see, for example, the wording of s 123(4).

<sup>316</sup> 1988 Act, s 124A(2).

<sup>317</sup> 1988 Act, ss 124A(3)(b) and 124D(2).

<sup>318</sup> 1988 Act, s 125(5). The Privy Council can also direct an HEC to (a) amend its articles of government or (b) secure that any rules or bye-laws made in pursuance of the articles of government are amended by the board of governors in any manner so specified: 1988 Act, s 125(6) and (7).

<sup>319</sup> 1988 Act, ss 129A(2) and 129B(2).

<sup>320</sup> 1988 Act, ss 129A(7) and 129B(4).

require Privy Council oversight (“the 2006 Letter”).<sup>321</sup> (We refer to provisions that require oversight as “the public interest matters”.) Those bodies were invited to submit proposals to the Privy Council for amended governing documents under which Privy Council oversight was retained only in respect of the public interest matters. HEIs governed by Royal Charter or Act of Parliament would move non-public interest matters from their statutes into ordinances, and HECs and designated institutions would move non-public interest matters from their instrument and articles of government into rules. The accompanying written Ministerial statement stated:

while the Government cannot require institutions to liberalise their governance arrangements, we very much hope that they will bring forward proposals that will relieve them of the obligation of having all amendments to their governing arrangements agreed by the Privy Council.<sup>322</sup>

5.130 Some HEIs took this opportunity to overhaul their governing documents, but many did not. HECs faced additional difficulties in seeking to overhaul their governing documents since the 1988 Act requires certain provisions to be included in their instrument and articles of government (and therefore to remain subject to Privy Council oversight).

5.131 In 2011 and 2012, concerns about amendment procedures for HEIs were raised in Government consultations and the Government agreed that improvements could be made.<sup>323</sup>

### The Consultation Paper

5.132 In the Consultation Paper, we endorsed the approach taken in the 2006 Letter of setting out the public interest matters to allow HEIs to re-allocate provisions in their governing documents so that their future amendment is subject to an appropriate level of oversight.<sup>324</sup> We asked consultees whether, and if so how:

- (1) the new minor amendment power that we proposed should apply to HEIs;
- (2) the 2006 list of public interest matters should be revised; and

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<sup>321</sup> This followed the White Paper, *The Future of Higher Education* (2003) Cm 5735, para 7.10, available at <https://publications.parliament.uk/pa/cm200203/cmselect/cmmeduski/425/425.pdf>. Similar letters were sent by the Department for Education and Skills to English HEIs and by the Welsh Government to Welsh HEIs, since higher education is devolved to Wales.

<sup>322</sup> *Hansard* (HC), 7 Feb 2006, vol 442, col 43WS, Minister for Higher Education and Lifelong Learning (Bill Rammell). No accompanying statement was made by the Welsh Government.

<sup>323</sup> *Students at the Heart of the System* (June 2011) Cm 8122, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf); Department for Business, Innovation and Skills, *A new, fit for purpose regulatory framework for the higher education sector* (August 2011), ch 5, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31382/11-1114-new-regulatory-framework-for-higher-education-consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31382/11-1114-new-regulatory-framework-for-higher-education-consultation.pdf); *Government response to ‘Students at the heart of the system’ and ‘A new regulatory framework for the higher education sector’* (June 2012), para 3.9, and summary of responses to question 22, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/209212/12-890-government-response-students-and-regulatory-framework-higher-education.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209212/12-890-government-response-students-and-regulatory-framework-higher-education.pdf). All publications concerned English HEIs.

<sup>324</sup> Consultation Paper, para 4.100.

(3) the 1988 Act and other individual Acts governing HEIs could be improved.<sup>325</sup>

5.133 Most consultees thought that the current amendment procedures for HEIs were overly restrictive, burdensome and complex. There was a call for one amendment regime that applies to all HEIs. Consultees were generally supportive of both (a) the reallocation approach, and (b) the creation of a power to make minor amendments that was tailored to HEIs.

5.134 As for the reallocation approach, both before and during consultation, we heard criticisms that deregulation by way of the 2006 Letter did not go far enough; in particular, amendments to the “Model Statute” (concerning employment matters) were to remain subject to Privy Council control. In fact, we were told by officials from (what was then) the Department for Business, Innovation and Skills (“BIS”) that – as far as English HEIs were concerned – it subsequently removed two matters from the list of public interest matters in the 2006 Letter, including the Model Statute, but there appeared to be little knowledge in the sector of the change.

### English HEIs: BIS 2015 Green Paper

5.135 After the close of our consultation period, BIS published a Green Paper<sup>326</sup> with various proposals concerning the amendment of English HEIs’ governing documents, including:

- (1) simplifying the requirements for HEC’s governing documents in the 1988 Act as part of proposals for wider deregulation of HECs’ constitutional arrangements;<sup>327</sup> and
- (2) simplifying the role of the Privy Council in approving amendments by:
  - (a) “reviewing, with input from the sector, the current principles of public interest [in the 2006 Letter], and to issue a further Ministerial letter to Vice Chancellors explaining the options and including detailed guidance on how to deregulate governing documents and the process and timing for doing so”;<sup>328</sup> and
  - (b) “In the longer term, the Government is seeking views on removing the requirement for changes to the governing documents of HEFCE<sup>329</sup>-funded providers to be approved by the Privy Council. Responsibility for protecting the public interest in their governing documents would transfer to the [new

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<sup>325</sup> Consultation Paper, paras 4.104 to 4.110.

<sup>326</sup> Fulfilling our Potential: Teaching Excellence, Social Mobility and Student Choice (November 2015) Cm 9141 (“the Green Paper”), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/474227/BIS-15-623-fulfilling-our-potential-teaching-excellence-social-mobility-and-student-choice.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/474227/BIS-15-623-fulfilling-our-potential-teaching-excellence-social-mobility-and-student-choice.pdf).

<sup>327</sup> Green Paper, Part C, ch 3, paras 6 and 7.

<sup>328</sup> Green Paper, Part C, ch 3, para 15.

<sup>329</sup> Higher Education Funding Council for England.

Office for Students], with the principles of public interest incorporated in to the terms and conditions of grant funding."<sup>330</sup>

5.136 In January 2016, we shared with BIS consultees' responses to our Consultation Paper concerning HEIs. In addition, we shared with BIS our intended recommendations for reform following consultation, which we set out below.

### **Our conclusions following consultation**

5.137 As explained above, in relation to statutory and Royal Charter charities generally, we recommend that guidance be provided concerning (1) the process for amendment, and (2) the categories of provision that generally require oversight, so as to facilitate an overhaul of charities' governing documents.

#### (1) Guidance concerning the process

5.138 Consultation revealed that HEIs – like other statutory and Royal Charter charities – would be assisted by guidance about the amendment process, with some consultees suggesting that there could be specific guidance for HEIs. Our view following consultation was that such guidance would be helpful.

#### (2) Guidance concerning re-allocation

5.139 Our recommendation for all Royal Charter charities is that the PCO issue guidance concerning the matters that should generally appear in a charity's Charter, bye-laws and regulations, in order to facilitate the re-allocation of provisions as part of an overhaul of a charity's governing documents. Such guidance for HEIs has already been issued in the 2006 Letter, and we continue to endorse an approach whereby HEIs are provided with guidance concerning the public interest matters, and encouraged to overhaul their governing documents so as to remove non-public interest matters from Privy Council oversight.

5.140 Our view following consultation was that the current position could be improved for HEIs in two respects.

- (1) Guidance as to the public interest matters should be placed on a formal basis by being set out in guidance issued by Government or an appropriate public body. The 2006 Letter was helpful, but it was informal. Consultation revealed a lack of knowledge amongst those in the higher education sector both as to the existence of the 2006 Letter, and also as to the subsequent removal (in England) of two matters from the list of public interest matters.
- (2) The list of public interest matters should be reviewed and updated, following consultation with the sector, and should continue to be updated over time.

#### (3) Higher education corporations

5.141 Guidance concerning the public interest matters would assist HEIs in carrying out an overhaul of their governing documents; matters that are not on the public interest list

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<sup>330</sup> Green Paper, Part C, ch 3, para 16. A similar suggestion was made to us by Bates Wells Braithwaite who, together with University of Birmingham, commented that existing regulation by the HEFCE seeks to ensure good governance.



can be removed from Privy Council control. There would, however, remain a problem for HECs for whom the 1988 Act sets out the matters that must be contained in their governing documents. Pinsent Masons LLP said the Instrument and Articles of Government are “tied to the era of 1988 when HECs were set free from local authority control (but with strings attached)”. Consultees generally agreed that the prescriptive requirements in the 1988 Act as to the contents of HECs’ constitutions were now unnecessary. They prevent HECs from carrying out an overhaul of their governing documents in accordance with a list of public interest matters.

5.142 Our view following consultation was that the prescriptive requirements in the 1988 Act should be removed. Any overhaul of an HEC’s or designated institution’s governing documents would still have to be approved by the Privy Council, but once overhauled the matters that fell outside the public interest list would thenceforth be capable of amendment without Privy Council oversight.

### **English HEIs: the Higher Education and Research Act 2017**

5.143 The proposals in the BIS Green Paper were taken forward in the HERA, which was introduced in May 2016 and received Royal Assent in April 2017. The HERA involves significant reform to HEIs, including two measures that address our three conclusions following consultation.<sup>331</sup>

(1) Guidance concerning the public interest matters

5.144 The new Office for Students (which is to replace HEFCE) is required to determine “initial registration conditions” and “general ongoing registration conditions” for HEIs.<sup>332</sup> Such conditions may include “a public interest governance condition”,<sup>333</sup> namely “a condition requiring the provider’s governing documents to be consistent with the principles in the list published under this section”.<sup>334</sup> The Office for Students must, following appropriate consultation, publish “a list of principles applicable to the governance of English higher education providers”, and the principles “must be those that the [Office for Students] considers will help to ensure that English higher education providers perform their functions in the public interest”.<sup>335</sup>

5.145 Accordingly, there is to be formal guidance – replacing and updating the 2006 Letter – issued by the Office for Students following consultation with the sector that sets out the public interest matters. HEIs can be required, as a condition of registration, to amend their governing documents in conformity with those public interest matters. The HERA therefore addresses, in England, our second conclusion following consultation.<sup>336</sup>

5.146 We hope that the Office for Students would, at the same time as publishing its guidance on the public interest matters, also publish guidance concerning the process for amending governing documents in accordance with that published list, or at least assist

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<sup>331</sup> Set out in paras 5.138 to 5.142 above.

<sup>332</sup> HERA, s 5.

<sup>333</sup> HERA, s 13(1)(b).

<sup>334</sup> HERA, s 14(1).

<sup>335</sup> HERA, s 14(2), (3) & (8).

<sup>336</sup> See paras 5.139 and 5.140 above.

HEIs in navigating the amendment process. Such guidance would address, in England, our first conclusion following consultation.<sup>337</sup>

## (2) Deregulation for HECs

5.147 The HERA removes the prescriptive requirements for the contents of HECs' governing documents set out in the 1988 Act. This reform will allow HECs to re-allocate provisions in their governing documents (removing some from Privy Council oversight) in accordance with the Office for Students' guidance concerning the public interest matters.

5.148 The HERA therefore also addresses, in England, our third conclusion following consultation.<sup>338</sup>

## Welsh HEIs

5.149 Since higher education is devolved to Wales, the HERA only applies to English HEIs. Welsh HEIs will therefore continue to be governed by the current law.<sup>339</sup>

5.150 Our three conclusions following consultation apply to both English and Welsh HEIs. We think that Welsh HEIs would be greatly assisted by (1) guidance concerning the process for amending governing documents, (2) guidance concerning the public interest matters that should remain subject to oversight (issued either by Government or some other public body), and (3) removal of the prescriptive requirements for the constitutions of HECs under the 1988 Act.

5.151 In England, those policy aims have been addressed by the HERA. We recommend that the Welsh Government consider measures to address the current problems faced by Welsh HEIs. The reforms in the HERA provide one possible model for such measures, but that Act is by no means the only way in which the Welsh Government could respond to the difficulties faced by Welsh HEIs. For example, the provision of guidance concerning the amendment process, and guidance concerning the public interest matters (updating the 2006 Letter), does not require primary legislation. Deregulation for HECs would, however, require amendment of the 1988 Act by primary legislation. We have discussed our conclusions with officials from the Welsh Government, and are encouraged that the Welsh Government has recently published a consultation seeking views on amending the legislation governing HECs under the 1988 Act.<sup>340</sup>

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<sup>337</sup> See para 5.138 above.

<sup>338</sup> See paras 5.141 and 5.142 above.

<sup>339</sup> Summarised in paras 5.124 to 5.128 above.

<sup>340</sup> Welsh Government, *Public Good and a Prosperous Wales – Building a reformed PCET system* (WG31891, 20 June 2017), at 44-45, available at [https://consultations.gov.wales/sites/default/files/consultation\\_doc\\_files/170620\\_reformed\\_pcet\\_system\\_final\\_en.pdf](https://consultations.gov.wales/sites/default/files/consultation_doc_files/170620_reformed_pcet_system_final_en.pdf).

### **Recommendation 10.**

5.152 We recommend that, in order to facilitate the amendment of, and the re-allocation of provisions within, the governing documents of Welsh higher education institutions (“HEIs”), the Welsh Government should consider introducing the following measures:

- (1) the publication of guidance concerning the process for amending governing documents;
- (2) following consultation with the sector, the publication of guidance (either by the Welsh Government or some other public body) setting out the matters of public interest in the governing documents of HEIs, amendment of which should remain subject to oversight; and
- (3) the removal of the requirements in the Education Reform Act 1988 as to the content of the governing documents of higher education corporations so as to enable those bodies to re-allocate provisions in accordance with guidance concerning public interest matters.

### **HEIs with individual Acts of Parliament**

5.153 Some HEIs are governed by individual Acts of Parliament.<sup>341</sup> Such HEIs must obtain Privy Council consent to any amendment of their statutes and they will therefore be able to take advantage of guidance on public interest matters in order to overhaul their governing documents. Pinsent Masons LLP reported, however, that these HEIs face greater difficulties in making constitutional amendments than HEIs governed by Royal Charter since “the Act prescribes the content of underlying statutes”. In so far as an HEI’s individual Act of Parliament prevents it from making constitutional amendments in accordance with the guidance on public interest matters, we would encourage it to seek a section 73 scheme to change the effect of the governing Act. Moreover, it might be possible for the small number of HEIs with individual governing Acts of Parliament to join together in seeking one section 73 order to effect the necessary changes to their governing Acts.

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<sup>341</sup> See para 5.126 above.

# Chapter 6: Cy-près schemes and the proceeds of fundraising appeals

## INTRODUCTION

- 6.1 Charities often undertake fundraising appeals for a particular purpose, for example, to fund repairs to the charity's buildings, to purchase an item of equipment, or to assist the victims of a natural disaster. It can be difficult to predict how much money will be needed for the purpose, and even harder to estimate how much will be raised by the appeal. Sometimes that will not matter; the money raised by the appeal can be applied to the particular purpose and what the charity can do will depend on the amount raised. But where a particular sum is required to achieve the purpose of the appeal (for example, to rebuild a church hall), the appeal may not raise enough money, or it may raise more than is needed. We refer to appeals that do not raise enough money as "failed appeals", and appeals which raise more than is needed as "surplus cases".
- 6.2 Both kinds of fund can, in some circumstances, be applied to other purposes under a cy-près scheme. Lord Hodgson recommended that "proceeds of a failed appeal should be applied for the charity's general purposes unless the donor expressly requests otherwise..."<sup>342</sup> This chapter arises from that recommendation.
- 6.3 In this chapter, we summarise the current law and then make recommendations to expand and simplify the situations in which funds from failed appeals and surplus cases can be applied cy-près.

## THE CURRENT LAW

### General charitable intention

- 6.4 We discussed cy-près schemes above.<sup>343</sup> We distinguished between:
- (1) the initial failure of a charitable gift, for which a general charitable intention on the part of the donor is a pre-requisite to a cy-près scheme; and
  - (2) the subsequent failure of a charitable gift, for which there is no requirement for a general charitable intention before a cy-près scheme can be made.

### Surplus funds

- 6.5 It is generally accepted that, when an appeal raises more money than is needed, there is a subsequent failure of the particular charitable purpose as regards the surplus.<sup>344</sup> As

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<sup>342</sup> Hodgson Report, Appendix A, para 4.

<sup>343</sup> See para 4.37 and following.

<sup>344</sup> Charity Commission, *OG53 Charitable appeals: avoiding and dealing with failure* (November 2014) para 1.4 available at <http://ogs.charitycommission.gov.uk/g053a001.aspx>. This is the view expressed in H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 505 to 506, though the author also suggests that a surplus arising from a written instrument of gift, as opposed to a fundraising appeal, is an initial failure and a general charitable intention is required: p 493. The authors of *Tudor on Charities* prefer

long as the donation was an outright gift,<sup>345</sup> there is no need for the donors to have had a general charitable intention for the surplus funds to be applicable cy-près.

- 6.6 The Charity Commission can make a cy-près scheme directing that the surplus funds be used for other charitable purposes. The section 67 similarity considerations will apply when making the scheme.<sup>346</sup>

### Failed appeals

- 6.7 When insufficient funds are raised to carry out a particular purpose, it is generally considered to be a case of initial failure.<sup>347</sup> Depending on the terms of the fundraising literature, it may be possible to find a general charitable intention on the part of the donors, in which case a cy-près scheme can be made. But, generally, when a donation has been made to a particular appeal, there will be no general charitable intention on the part of donors.

### Identifiable donors

- 6.8 Historically, where donations were made by identifiable donors without a general charitable intention, a cy-près scheme could not be made in respect of those donations. Instead, the charity trustees held the funds on resulting trust for the donors and had to return the funds to them.<sup>348</sup> If the donors could not be found, the money had to be paid into court.<sup>349</sup>
- 6.9 Special provision was made by the Charities Act 1960 for the Charity Commission to make cy-près schemes in respect of donations from identifiable donors if the charity trustees had reasonably attempted, but failed, to find the donors to offer them a refund.<sup>350</sup>

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the view that all gifts leaving a surplus are cases of subsequent failure, and that a cy-près scheme can be made if there has been an outright gift: *Tudor on Charities* (10th ed 2015) paras 10-081 to 10-087.

<sup>345</sup> That is, there were no conditions attached to the gift; see *Tudor on Charities* (10th ed 2015) paras 10-070 to 10-080; compare H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 462 to 465, 471 to 472 and 505, where the author questions whether even an outright gift is necessary.

<sup>346</sup> The s 67 similarity considerations are discussed in para 4.45. The requirement to establish a s 62 cy-près occasion is effectively redundant since the existence of a surplus, by definition, means that the particular charitable purpose has been achieved which will fall within s 62(1)(a)(i) or s 62(1)(b).

<sup>347</sup> Charity Commission, *OG53 Charitable appeals: avoiding and dealing with failure* (November 2014) section 1.4; *Tudor on Charities* (10th ed 2015) paras 9-037 to 9-039; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 497 to 498.

<sup>348</sup> *Re Ulverston and District New Hospital Building Trusts* [1956] Ch 622; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 498.

<sup>349</sup> Trustee Act 1925, s 63.

<sup>350</sup> Charities Act 1960, s 14(1).

## Unidentifiable donors

- 6.10 The historical treatment of donations from unidentifiable donors was more difficult. It was unclear whether a general charitable intention ought to be imputed to unidentifiable donors, and hence whether a cy-près scheme could be made.<sup>351</sup>
- 6.11 The Charities Act 1960 provided that the Charity Commission could make a cy-près scheme in respect of donations from donors who cannot be identified following reasonable advertisements and inquiries by the trustees. It also created a presumption that proceeds of cash collections and money raised from lotteries and competitions were given by donors who could not be identified, thereby allowing a cy-près scheme to be made in respect of those proceeds.<sup>352</sup> The authors of *Tudor on Charities* describe this reform as “in effect, a statutory presumption that unidentified donors have a general charitable intention”.<sup>353</sup>

## The current regime

- 6.12 If a fundraising appeal informs donors that the funds will be used for other purposes in the event that the principal purpose cannot be achieved, the charity trustees are free to use the funds for those other purposes.<sup>354</sup> Otherwise, the situation is one where funds have been donated for a specific charitable purpose which has failed and so the charity trustees must invoke the provisions of sections 63 to 66 of the Charities Act 2011<sup>355</sup> and, where relevant, comply with the detailed requirements set out in the Charities (Failed Appeals) Regulations 2008 (“the 2008 Regulations”).<sup>356</sup>
- 6.13 The Charities Act 2011 provides that the purpose of an appeal fails if any difficulty in applying the proceeds of the appeal to that purpose makes them available to be returned to the donors.<sup>357</sup> Sections 63 to 66 of the Charities Act 2011 permit the Charity Commission to make a cy-près scheme in relation to the proceeds of a failed appeal in any of five situations.

### *Case (1): Donors who cannot be identified or found*

- 6.14 First, a cy-près scheme can be made in respect of funds given by a donor who cannot be identified, or cannot be found, after certain advertisements are published and inquiries are made: see Figure 9.<sup>358</sup> If a donor has not responded to the advertisements and inquiries within three months, a cy-près scheme may be made.<sup>359</sup> If a donor makes

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<sup>351</sup> *Re Hillier's Trusts* [1954] 1 WLR 700; *Re Ulverston and District New Hospital Building Trusts* [1956] Ch 622, 637 to 641; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 498 to 500; *Tudor on Charities* (10th ed 2015) para 9-047.

<sup>352</sup> Charities Act 1960, s 14(1) and (2).

<sup>353</sup> *Tudor on Charities* (10th ed 2015) para 9-047.

<sup>354</sup> See further paras 6.23 to 6.26 below.

<sup>355</sup> Which provide for the application of property cy-près where a donor is unknown or disclaiming.

<sup>356</sup> The 2008 Regulations were made by the Charity Commission under the powers conferred on it by ss 14(8) and (9) and 14A(9) of the Charities Act 1993.

<sup>357</sup> Charities Act 2011, s 66(1).

<sup>358</sup> Charities Act 2011, s 63(1)(a).

<sup>359</sup> Charities Act 2011, s 63(2); 2008 Regulations, reg 7.

a claim within six months of the date of the scheme for the return of his or her donation, the trustees must repay the donation to the donor, subtracting any expenses incurred by the trustees after the date of the scheme in administering the claim.<sup>360</sup> After six months, the donor loses any entitlement to repayment.

**Figure 9: requirements for advertisements in the 2008 Regulations<sup>361</sup>**

- (1) Advertisements must be published in English and, where the appeal was published in another language, in that language.
- (2) Advertisements must be published in a newspaper or other periodical which is:
  - (a) written in the same language as the advertisement; and
  - (b) sold or distributed throughout the area in which the appeal was made.
- (3) Where the purposes of the appeal were directed towards the benefit of an area wholly or mainly within a local authority district, a London Borough, or the City of London, a copy of every advertisement must be published by fixing copies of it to two public notice boards in the relevant area.
- (4) Advertisements must be in the following prescribed form:

**ADVERTISEMENT**

Name of charity (if applicable):

Registered charity number (if applicable):

Purpose for which money or other property was given:

NOTICE is given that money and other property given for this purpose cannot be used for that purpose because [state reasons].

If you gave money or other property for that purpose you are entitled to claim it back. If you wish to do so you must tell [insert name] of [insert address] within 3 months of [specify date]. If you wish the money or other property to go to a similar charitable purpose and to disclaim your right to the return of the money or other property, you must ask the person named above for a form of disclaimer.<sup>362</sup>

If you do not either make a claim within the three months or sign a disclaimer, the Charity Commission may make a Scheme applying the property to other charitable purposes. You will still be able to claim the return of your money or other property (less expenses), but only if you do so within 6 months from the date of any Scheme made by the Commission.

Date of this notice: [specify date]

<sup>360</sup> Charities Act 2011, s 63(4) to (5). If the total sum set aside to meet such claims is insufficient, the Charity Commission may direct that the donors shall receive a proportionate share of that fund: s 63(6) to (7).

<sup>361</sup> 2008 Regulations, regs 3-5 and sch 1 and 2.

<sup>362</sup> See Case (2) below.

*Case (2): Donors disclaiming*

6.15 Second, a cy-près scheme can be made in respect of funds given by donors who have disclaimed their right to have the funds returned using the prescribed form: see Figure 10.

**Figure 10: form of disclaimer under the 2008 Regulations<sup>363</sup>**

A disclaimer must be executed in English as follows (or in Welsh in the form equivalent in that language):

I HEREBY DISCLAIM my right to the return of the sum of £...../ the property consisting of (insert description of property) given by me for (insert name of charity to which, or descriptions of purposes for which, the money or property was given).

Signed:

Name in capitals:

Address:

Date:

*Case (3): Donors treated as disclaiming*

6.16 Third, a cy-près scheme can be made in respect of funds given by a donor where the donor is treated as having disclaimed any right to the return of the donation.<sup>364</sup> The provision applies where:

- (1) the appeal or request informs donors that their donations will be applied cy-près in the event that the specific purposes fail; and
- (2) the donor is given the opportunity to make a written declaration at the time of making the donation that, in the event that the specific purposes fail, he or she wishes the charity trustees to give him or her the opportunity to request the return of the donation (“a Declaration”).

6.17 If the donor does not make a Declaration, then in the event that the specific purposes fail the property can be applied cy-près.<sup>365</sup>

6.18 If the donor does make a Declaration, then a cy-près scheme can still be made if:

- (1) the charity trustees have written to the donor<sup>366</sup> with the information set out in Figure 11; and

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<sup>363</sup> Charities Act 2011, s 63(1)(b). The form of the disclaimer is prescribed by the 2008 Regulations, reg 8 and sch 4.

<sup>364</sup> Charities Act 2011, s 65. The provision was introduced by the Charities Act 2006, s 17, inserting s 14A of the Charities Act 1993.

<sup>365</sup> Charities Act 2011, s 65(7).

<sup>366</sup> The trustees are required to maintain a written record of donors’ declarations and of their addresses, including any change of address notified to them by donors: 2008 Regulations, regs 9, 10 and 12.



- (2) the donor has not been found or does not request the return of the donation within three months.<sup>367</sup>

**Figure 11: notification to be given to donors who have made a Declaration**

The notification must:

- (1) state the nature or value of the property (as applicable) and the specific charitable purpose for which it was given;
- (2) inform the donor that the specific charitable purpose has failed;
- (3) enquire whether, in accordance with the declaration which he or she made, the donor wishes to request the return of the property (or a sum equal to its value);
- (4) advise the donor that if he or she wishes to exercise his or her right to request the return of the property, he or she must do so within three months of the trustees sending the written notification; and
- (5) advise the donor that if he or she does not reclaim the property, the Charity Commission may make a Scheme to apply it for other similar charitable purposes.

*Case (4): Cash collections and the proceeds of certain fundraising activities*

6.19 Fourth, a cy-près scheme can be made in respect of funds given by a donor through (a) a cash collection, either by means of a collecting box or by other means “not adapted for distinguishing one gift from another”, or (b) “the proceeds of any lottery, competition, entertainment, sale or similar money-raising activity”.<sup>368</sup>

*Case (5): Return of the donations would be unreasonable*

6.20 Fifth, a cy-près scheme can be made in respect of funds given by a donor where the court or Charity Commission<sup>369</sup> considers:

- (1) that it would be unreasonable, having regard to the amounts likely to be returned to the donors, to incur expense with a view to returning the property; or
- (2) that it would be unreasonable, having regard to the nature, circumstances and amounts of the gifts, and to the lapse of time since the gifts were made, for the donors to expect the property to be returned.<sup>370</sup>

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<sup>367</sup> Charities Act 2011, s 65(4) to (6); 2008 Regulations, regs 11 and 13.

<sup>368</sup> Charities Act 2011, s 64(1).

<sup>369</sup> Originally, such an order could only be made by the court. The power was extended to the Charity Commission by the Charities Act 2006, s 16, which amended Charities Act 1993, s 14(4). See now Charities Act 2011, s 64(2).

<sup>370</sup> Charities Act 2011, s 64(2).

6.21 In its guidance, the Charity Commission states that, if the total funds raised were less than £1,000 and all came from unidentifiable donors, the Commission “may decide that the trustees can automatically apply the funds for purposes similar to those of the original appeal, without any legal authority from us”.<sup>371</sup>

### **National Health Service charities**

6.22 The National Health Service Act 2006 makes special provision for National Health Service (“NHS”) charities. In the case of failed appeals, the trustees are permitted to apply the proceeds to other similar purposes of the charity.<sup>372</sup> Accordingly, the requirement for a general charitable intention is overridden and there is no need to use Cases (1) to (5). A similar power exists for NHS charities in respect of surplus funds.<sup>373</sup>

### **Avoiding the difficulties of failed appeals and surplus funds**

6.23 In summary, charities face three problems under the current law.

- (1) In the case of failed appeals, donors cannot usually be shown to have a general charitable intention, so the default position is that donations must be returned, unless particular conditions can be satisfied in order to make the donations applicable *cy-près* (i.e. Cases (1)-(5) above). That difficulty does not arise in surplus cases, since there is no requirement for a general charitable intention; the surplus can therefore be applied *cy-près*.
- (2) In surplus cases it can be unclear which individual donations comprise the surplus to be applied *cy-près*. If particular donations are not given as outright gifts,<sup>374</sup> complicated questions arise as to which gifts have been used to achieve the purpose of the appeal, and whether individual gifts (which are not outright gifts) can be appropriated by the trustees so as to prevent them forming part of the surplus.
- (3) In the case of failed appeals (where one of the conditions for the donations to be applicable *cy-près* in Cases (1) to (5) is met) and in surplus cases, the trustees need to obtain a *cy-près* scheme before the fund can be used for other purposes.

6.24 These difficulties arise from the fact that gifts are given for a specific charitable purpose. The Charity Commission recommends that charity trustees should consider phrasing their fundraising literature in such a way that would prevent the initiative from being limited to a specific charitable purpose.<sup>375</sup> The example given by the Charity Commission is a fundraising appeal stating:

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<sup>371</sup> Charity Commission, *OG53 Charitable appeals: avoiding and dealing with failure* (November 2014) para A1 2.4(d).

<sup>372</sup> National Health Service Act 2006, s 222(10).

<sup>373</sup> National Health Service Act 2006, s 222(7). When exercising these powers the trustees must have regard to the desirability of applying the funds for a purpose similar to that for which they were given: s 222(11).

<sup>374</sup> See para 6.5.

<sup>375</sup> Charity Commission, *OG53 Charitable appeals: avoiding and dealing with failure* (November 2014) para A1 1.2.

We are raising funds to buy a scanner for the hospital. If for any reason we can't buy the scanner, or there are surplus funds left over following the purchase of the scanner, we will use the money to buy other equipment that the hospital could not otherwise have.<sup>376</sup>

- 6.25 If insufficient funds are raised for a scanner, the charity trustees will be able to use the funds for the other specified purposes (the purchase of other equipment) without having to contact donors or obtain a cy-près scheme. Similarly, if too much is raised, the surplus can be used for other specified purposes. The terms of the fundraising appeal could even state that in the event that the primary purpose (here the purchase of the scanner) fails, the trustees will be able to use the money raised to support the charity's work generally. NCVO, ACF, CFG and IoF<sup>377</sup> noted that the Code of Fundraising Practice requires appeals for particular purposes to include a statement indicating what will happen to funds received if the total funds raised are insufficient or exceed the target.<sup>378</sup> This approach overcomes the difficulties identified in paragraph 6.23 above.
- 6.26 Some consultees said that failed appeals can be "easily avoided"<sup>379</sup> and that the best solution to the difficulties presented by failed fundraising appeals is to make express provision for the eventuality in the fundraising literature.<sup>380</sup> We endorsed such an approach in the Consultation Paper,<sup>381</sup> and we continue to agree that all of the difficulties that arise under the current law can be avoided if trustees think about and make provision for what will happen if their appeal raises insufficient, or surplus, funds.<sup>382</sup> We think that there should be greater awareness in the charity sector of the need to prepare fundraising literature carefully and to pre-empt the possibility of a failure or surplus. That is all the more important with the increasing popularity of crowdfunding

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<sup>376</sup> Charity Commission, *OG53 Charitable appeals: avoiding and dealing with failure* (November 2014) para A1 1.2.

<sup>377</sup> National Council for Voluntary Organisations; Association of Charitable Foundations; Charity Finance Group; and Institute of Fundraising.

<sup>378</sup> At the time of the response, the Code was prepared by the Institute of Fundraising. The Code is now the responsibility of the Fundraising Regulator, and equivalent provision is made in para 1.5(a) of the Code, available at <https://www.fundraisingregulator.org.uk/code-of-fundraising-practice/code-of-fundraising-practice-v1-4-310717-docx/>.

<sup>379</sup> The CLA.

<sup>380</sup> The CLA; Lawyers in Charities; Institute of Chartered Secretaries and Administrators; Lord Hodgson; Cancer Research UK; and Society for Radiological Protection.

<sup>381</sup> Consultation Paper, para 7.30.

<sup>382</sup> For those cases where trustees want to give donors the choice (rather than including secondary purposes in the fundraising literature), Stone King LLP suggested that online giving websites and Gift Aid forms could include a tick box which would allow donors to opt out of their donation being used for general purposes in the event of failure of the specific purpose. If carefully planned, we think that could be a sensible approach. If the box was not ticked by the donor, the first and third problem under the current law (in para 6.23 above) would be overcome. But trustees should consider the consequences of the box being ticked in the event of a failure or surplus. If the tick-box statement was limited to cases of initial failure (i.e. insufficient funds being raised, as opposed to surplus cases), then in a surplus case the funds would be applicable cy-près in the usual way. If insufficient funds were raised, it would mean that donations would have to be returned unless the trustees can rely on one of Cases (1)-(5) outlined above. If the statement also applied in the event of a surplus, there is a risk that trustees would put themselves in a more restrictive position; the donation would not be an outright gift so would have to be returned in the event of a surplus, whereas the fund would have been applicable cy-près if donors had not been given the option to tick the box. In summary, the tick-box approach could still give rise to the difficulties outlined in para 6.23 above.

and other online fundraising campaigns for specific purposes. But there will remain cases where trustees do not address the possibility of a failure or a surplus in advance, either by omission or a deliberate decision not to include a secondary purpose in their fundraising literature.

## ANALYSIS

6.27 Failed appeals concern initial failure, so at common law the funds could not be applied cy-près unless the donors had a general charitable intention. Cases (1) to (5) relax that position by setting out circumstances in which funds from failed appeals can be applied cy-près, despite the absence of a general charitable intention.<sup>383</sup>

### The issues

#### Failed appeals

6.28 Our consideration of failed appeals raises three issues.

- (1) Issue (A): Should the precondition to a cy-près scheme, namely the requirement for a general charitable intention, be removed in respect of failed appeals? That would remove with it the need for Cases (1) to (5).
- (2) Issue (B): If not, can the procedures for Cases (1) to (5) be improved?
- (3) Issue (C): If a cy-près scheme can be made (either because the requirement for a general charitable intention is removed, or because one of Cases (1) to (5) apply), should the trustees be permitted to apply the funds cy-près without the involvement of the Charity Commission?

#### Surplus cases

6.29 Issues (A) and (B) do not arise in relation to surplus cases since there is no requirement for there to be a general charitable intention on the part of the donors; Cases (1) to (5) are therefore irrelevant. Surplus cases do, however, raise Issue (C): should trustees have the power to apply the surplus cy-près without the involvement of the Charity Commission?

6.30 We turn to consider Issues (A), (B) and (C) in turn. Our consideration of each Issue involves consideration of Cases (1) to (5).

### Issue (A): failed appeals – the requirement for a general charitable intention

6.31 In the light of the complexity of Cases (1), (2) and (3), it is arguable that the requirement, in the case of failed appeals, for a general charitable intention should be removed. There would then be no need for trustees to follow the procedures in Cases (1) to (3) (and Cases (4) and (5) would become irrelevant). That would allow the proceeds of failed appeals to be applied cy-près more easily.

#### The Consultation Paper

6.32 Our provisional view in the Consultation Paper was that the requirement for a general charitable intention should be retained. We said the requirement applied in all cases of

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<sup>383</sup> See para 6.12 and following above.

initial failure of a charitable gift and that the law had evolved over time to reflect, and protect, donor autonomy. We did not think that the requirement for a general charitable intention should be removed for one instance of initial failure (failed fundraising appeals) but retained for other instances of initial failure (such as gifts by will which are impossible). We said that, broadly, the circumstances in which the requirement for a general charitable intention can be overridden in Cases (1) to (5) strike a fair balance between donor autonomy and ensuring effective use of charitable funds. Instead, we suggested some improvements to Cases (1) to (3) (on which see Issue (B) below) as well as deregulation to allow small funds or small donations to be applied *cy-près* without having to follow the procedures in Cases (1) to (5).<sup>384</sup>

#### Removing the requirement generally

- 6.33 A significant minority of consultees thought that the requirement for a general charitable intention before the proceeds of a failed fundraising appeal can be applied *cy-près* should be removed, subject to any express intentions of donors. Stewardship said that, whilst it is difficult to generalise, “once a donation is made there is an expectation on the part of the donor that these funds will not be returned”. NCVO, ACF, CFG and IoF said “the culture of giving is changing – now, more often than not, people make donations without imposing restrictions because they are motivated by the end cause, rather than the particular project”. The attraction of reversing the default position is that it would remove the need for the section 63 to 66 procedures. The majority of consultees, however, thought that the requirement for a general charitable intention should be retained as an important protection of the wishes of donors.
- 6.34 Under the current law, donors to failed fundraising appeals are presumed to want their donations to be returned but that position will yield to any different statement of intention (for example, if donors execute disclaimers or simply decline the invitation to have their donation returned). Removing the requirement for a general charitable intention would effectively reverse the default position; donors to a failed fundraising appeal would be presumed to want their donations to be applied to other purposes, rather than have their donations returned.
- 6.35 Whilst some donors might expect their donations to be used for similar charitable purposes in the event of the original purposes failing (and perhaps particularly in the case of smaller donations), we do not think that it should be presumed as the default position. Moreover, we think that it is unrealistic to expect donors to attach express conditions to their gifts; an ordinary donor<sup>385</sup> to a fund is unlikely to say expressly that, if the appeal does not succeed, he or she would like the donation to be returned. Given that the rigours of the current presumption are mitigated by Cases (1) to (5), we think that reversing the default position would go too far in overriding donors’ wishes. We also note that reversing the default position would distinguish failed appeals from other instances of initial failure.<sup>386</sup> We have therefore concluded that the requirement for a general charitable intention as a precondition to a *cy-près* scheme in the case of failed appeals should be retained; we do not think that it is appropriate, or realistic, to expect

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<sup>384</sup> Consultation Paper, paras 7.32 to 7.38.

<sup>385</sup> Donors of very large sums might fall into a separate category and impose particular conditions on their gift.

<sup>386</sup> See para 6.32 above.

donors to impose express conditions on their gift if they do not want their gift to be applied cy-près.<sup>387</sup>

#### Removing the requirement for small funds or small donations

- 6.36 We asked consultees whether it should be possible to apply small funds or small donations cy-près in spite of the absence of a general charitable intention. We said that, arguably, donors' wishes should be protected in the same way regardless of the size of the fund or the size of their donations, but when the fund or donation is small, the costs of administering it in accordance with Cases (1) to (5) will often be disproportionate.
- 6.37 The majority of consultees thought that, whilst the requirement for a general charitable intention should be retained, it should be possible to apply small funds or small donations cy-près despite the absence of such a general charitable intention. They thought that donors of small amounts are less likely to object to their donations being used for different purposes than donors of large sums, and that deregulation for small funds or small donations was a practical and proportionate compromise between the competing interests.
- 6.38 There is a balance to be struck between (a) protecting donors' wishes, and (b) the administrative inconvenience and expense of seeking to contact donors to offer a refund. Indeed, we think that many donors of small sums would not expect trustees to incur (and might even disapprove of trustees incurring) expense in seeking to contact them to offer them a refund of a small donation. We have therefore concluded that there should be deregulation in respect of small funds or small donations.<sup>388</sup>
- 6.39 The same result can often already be achieved by seeking an order from the Charity Commission,<sup>389</sup> but a tailored statutory procedure for applying small funds and small donations to similar purposes would be attractive to trustees, particularly if they can operate the procedure without the involvement of the Charity Commission (on which, see Issue (C) below).

#### Thresholds for small funds, small donations, or both

- 6.40 In the Consultation Paper, we suggested that appeals that raised a small amount, say £1,000 or £5,000, could be applied cy-près, and that small donations, say £100 or £500, could be applied cy-près. Some consultees thought that there should be both a fund

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<sup>387</sup> This approach would see initial failure and surplus cases continuing to be treated differently, as regards the requirement for a general charitable intention before the fund can be applied cy-près. In order to remove that inconsistency, rather than removing the requirement for a general charitable intention in the case of initial failure, it would be possible to *introduce* a requirement for a general charitable intention in surplus cases. We did not consult on that option, and we think that it would be illogical. We say above that removing the requirement for a general charitable intention in failed appeal cases would see failed appeals being treated differently from other cases of initial failure (for which the requirement of a general charitable intention would remain). Equally, introducing a requirement for a general charitable intention in surplus cases would see surplus cases being treated differently from other cases of subsequent failure (for which there would continue to be no requirement for a general charitable intention).

<sup>388</sup> Only one consultee disagreed with deregulation for small donations or small funds on the basis that it would create a distinction between fundraising appeals and other instances of failure. There is, however, already such a distinction by reason of the tailored regime for failed appeals in sections 63 to 66 (Cases (1) to (5) above).

<sup>389</sup> See Case (5), paras 6.20 to 6.21 above.

threshold and a donation threshold. They generally thought that such thresholds should operate cumulatively, so small donations would only be applicable cy-près if the total fund also fell below a financial threshold. A minority thought that they should operate as alternatives, so that small donations should be applicable cy-près (regardless of the total fund value), and that small funds should be applicable cy-près (regardless of the size of the constituent donations).

- 6.41 Stone King LLP queried the need for a fund threshold because even small funds might include large donations. “For example, you could have a fund of £10,000 which contains only donations of £10 or less, and a fund of £5,000, that contains two donations of £1,000 each. ... the individuals who gave the £1,000 are far more likely to have views on whether the donation should be used for general charitable purposes than the individuals giving £10, and the aim of the legislation is to protect that donor intention where it exists, and so we would only have a limit on the size of donations.”
- 6.42 We agree with Stone King LLP’s argument, although it is only relevant in so far as a fund threshold would operate as an alternative to a donation threshold. If the two thresholds operated cumulatively, the fund threshold would simply be an additional limitation on the scope of the power. But is it necessary to limit the cy-près application of large funds when all the constituent donations are small? No matter how large the fund, if every donation is less than £20, it will remain administratively disproportionate for the trustees to contact all the donors to offer a refund (and the donors, too, might think that such action is a disproportionate use of the charity’s funds). The extent to which individual donor autonomy is overridden is no different in the case of a large fund simply because there have been more donors. We have therefore concluded that small donations should be applicable cy-près, regardless of the overall size of the fund.<sup>390</sup>

#### Setting the threshold

- 6.43 The Association of Church Accountants and Treasurers pointed out that the threshold should apply in respect of each donor, and not in respect of each donation. Multiple donations might be given by the same donor, and the question should be whether the donor’s total donations to the appeal exceed the threshold, not whether each donation exceeds that threshold. In principle, we agree. There might be some concerns about the practicality of requiring charities to identify all the donations to a fund made by each donor. It is likely that charities would often be able to identify all donations from an individual donor relatively easily, for example from bank account statements, or from Gift Aid records (since the names and addresses of donors must be recorded and included on the claim form submitted to HMRC). Nevertheless, in order to address concerns about the ability of charities to identify donors, our recommendation is that the threshold should be based on the total donations made by a donor over the course of a financial year: trustees would not need to examine records covering many years to ascertain whether a donor had given more than the specified amount to the fund. In addition, we recommend that the test should be satisfied where, after taking reasonable steps to ascertain the identity of donors to the fund, the trustees believe that a donor’s total donations do not exceed the threshold; the utility of our recommendation would be

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<sup>390</sup> Similarly, we think that small donations should be applicable cy-près even if the fund also comprises other donations that exceed the small donation threshold (and in respect of which trustees would have to take steps to contact the donors).

reduced if the trustees had to be certain that they had identified all of a donor's donations.

6.44 Consultees' views differed as to an appropriate donation threshold, ranging from £10 or £20<sup>391</sup> to £500,<sup>392</sup> the most common suggestion being £100. The threshold should be based on what donors would, in general, consider to be a relatively small donation, which does not justify the time and expense of offering a refund in the event of failure of the original purposes. We discussed the threshold with the CLA. In response to our proposal that the threshold should be based on a donor's total donations in a financial year, the CLA suggested a threshold of £120, which would include a common donation pattern of £10 per month. As we discuss elsewhere, setting a threshold is inevitably arbitrary but, drawing on the views of consultees and the sense of capturing small sums given by regular donors over one year, we have concluded that the threshold should be set at £120. As with other thresholds in the Charities Act 2011, we think that it should be capable of amendment by secondary legislation.

6.45 Should donors be able to prevent their small donations becoming applicable cy-près under this reform? A balance has to be struck between donor autonomy and efficiency. We think that, if a donor expressly states that his or her donation should not be applied for other purposes, the donation should not be applicable cy-près under this reform. A donor is very unlikely to do so, and other options will remain available for applying such a donation cy-près: see our discussion of Cases (1) to (5) under Issue (B) below. But as this additional ground for applying property cy-près is based on the view that donors would not generally expect small donations to be returned, if a donor has expressly stated that his or her small donation should be returned we think that should be respected.

#### **Recommendation 11.**

6.46 We recommend that:

- (1) in the case of failed appeals, a donation should be applicable cy-près without the trustees having to take steps to contact the donors in order to offer to return the donation if:
  - (a) the donation does not exceed £120; and
  - (b) the trustees reasonably believe that the total given by the donor to the fundraising appeal over the financial year did not exceed £120;unless the donor states that the donation must be returned if the specific charitable purposes fail.
- (2) those financial thresholds should be capable of amendment by way of secondary legislation.

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<sup>391</sup> Bates Wells Braithwaite.

<sup>392</sup> Cancer Research UK and Association of Church Accountants and Treasurers.



6.47 Clause 6 of the draft Bill, inserting section 63A(3) into the Charities Act 2011, would give effect to this recommendation.

**Issue (B): failed appeals – the procedures in Cases (1) to (5)**

6.48 In the Consultation Paper, we said that Cases (4) and (5) are helpful provisions, allowing cash collections to be applied cy-près and allowing the Charity Commission to dispense with the advertisement and inquiry processes. But we said that Case (1) – requiring advertisements and inquiries, then offering refunds – is cumbersome, and that Cases (2) and (3) – requiring a disclaimer or declaration from donors – seemed unrealistic and we doubted that they were used.

Case (1): advertisement and inquiry

6.49 Under the original regime in the Charities Act 1960, the steps to be taken were not set out in statute. That led to an application for directions in *Re Henry Wood National Memorial Trust*<sup>393</sup> in which the Judge directed that reasonable steps in that case required adverts to be placed in two editions of each of the three national newspapers, as well as notices being sent to the recorded addresses of donors. The requirements in the 2008 Regulations are therefore less onerous. Other jurisdictions only require the trustees to take reasonable steps to contact donors, as under the Charities Act 1960, rather than setting out detailed requirements in secondary legislation.<sup>394</sup>

6.50 In the Consultation Paper, we said that Case (1) could revert to a regime that does not prescribe the detailed steps to be taken, leaving the steps to trustee discretion, monitored by the Charity Commission which would decide whether reasonable steps had been taken before it would make a cy-près scheme. Alternatively, we suggested removing the requirement to advertise, leaving only a requirement to make inquiries of recorded donors.

6.51 The existing requirements were universally criticised by consultees as being disproportionate and out of date. Stone King LLP said the current regime “simply is not geared up for the ‘digital age’, where the ability to use notices on websites and email rather than using newspapers and post could be a significant advantage”. Similarly, Veale Wasbrough Vizards LLP said “Today, when a number of appeals are made online through Twitter, Facebook and online publications, it may be difficult to ascertain (a) which newspaper or periodical the advertisement should be placed in and (b) in which area the appeal was made.”

6.52 We made three suggestions for reform in the Consultation Paper.

- (1) Remove the advertisement requirements and retain the inquiries requirements.
- (2) Require trustees to take reasonable steps to contact donors, thereby giving them the flexibility to decide what steps (by way of advertisement, inquiry, or otherwise) to take.

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<sup>393</sup> [1966] 1 WLR 1601.

<sup>394</sup> See H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 502 to 503, discussing the position in the Republic of Ireland, Northern Ireland and Singapore.

(3) Simplify the 2008 Regulations.

- 6.53 The most popular suggestion among consultees was to replace the 2008 Regulations with a flexible requirement that the trustees take reasonable steps to contact donors: see paragraph 6.52(2). Some consultees suggested that trustees would be assisted by Charity Commission guidance in deciding on the appropriate steps. Others thought that appropriate steps should be agreed in advance with the Charity Commission.
- 6.54 Those consultees who favoured simplification of the 2008 Regulations (paragraph 6.52(3)) said that they should be brought up to date to permit, for example, notices to be placed on charities' websites and inquiries to be made by email or text message.
- 6.55 The purpose of the advertisement and inquiry requirements is to contact donors. The best way to contact donors will necessarily depend on how the appeal was conducted; it will differ depending on whether the appeal was made through newspapers or periodicals, on television, on the radio, on the charity's website, by social media (such as Twitter or Facebook), by fundraising on the street, by doorstep fundraising, or by a combination of these methods. Moreover, it is pointless to require charities to incur the expense of placing adverts in publications, or to require them to place notices on notice boards, if such adverts or notices are unlikely to be seen by donors.
- 6.56 We agree with those consultees who thought that the approach should be tailored to the particular appeal. We do not think that it is possible to devise an appropriate list of detailed requirements that would be suitable for all failed appeals. We have therefore concluded that the requirement should be to take reasonable steps to contact donors, whether that is by way of inquiries, notices, advertisements, or otherwise.
- 6.57 Most consultees thought that trustees should be left to decide reasonable steps, with guidance from the Charity Commission, and that the question of whether they had taken appropriate steps would be policed by the Charity Commission when it came to making a *cy-près* scheme.<sup>395</sup> If the Charity Commission is to continue to assess the adequacy of the steps taken by trustees to contact donors in all cases, we think that there is a risk of wasted expenditure by trustees if the Charity Commission is only involved when it comes to making a scheme. Trustees might take an overly cautious approach and expend funds on advertisements unnecessarily. Alternatively, trustees might not take sufficient steps and then be required by the Charity Commission to repeat the process, such that the expense of the first process will have been wasted since the steps will be duplicated (and increased).
- 6.58 We have therefore concluded that the appropriate steps to be taken by trustees to contact donors should be agreed with the Charity Commission in advance. We are cautious about increasing the Charity Commission's workload, but we think that this would be an insignificant demand on the Commission's resources. First, as was made clear in consultation, appeals rarely fail because either the funds raised can still be used (albeit less ambitiously) for their original purposes, or because the appeal literature includes secondary purposes. Second, trustees would be expected to devise their own proposals for the reasonable steps to be taken to contact the donors in their case. With appropriate guidance from the Commission about what it would generally consider to

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<sup>395</sup> We discuss, under Issue (C) below, whether that policing would continue in all cases.

be reasonable steps, trustees can be expected to suggest an appropriate range of steps for the Charity Commission then to approve. Third, the Commission must already assess whether trustees have complied with the detailed requirements in the 2008 Regulations before making a cy-près scheme. Under our recommended approach, the Commission would instead assess whether the trustees' proposals were reasonable and then whether the trustees had followed them.

#### *Post-scheme claims*

6.59 At present, donors have three months to respond to advertisements and inquiries after which a cy-près scheme can be made. But even after a cy-près scheme has been made, donors have a further six months to make a claim for the return of their donations. That additional six-month period was criticised by two consultees. The CLA said that it was onerous and unnecessary when communication with donors is “generally far simpler and quicker than it has ever been”. Anthony Collins Solicitors LLP went further and thought that the initial three-month period for donors to respond should be reduced to one month.

6.60 In accordance with the actions agreed between the charity and the Charity Commission to attempt to contact donors, donors will have a period of time to respond to the charity. Depending on the circumstances, that period might be three months (as it is at present), or it might be longer or shorter. But we think that, once trustees have taken steps to contact donors and donors have been given a reasonable period in which to respond, the funds should become applicable cy-près without any further redress by donors. We therefore recommend that the six-month period for making a claim after the proceeds of a failed appeal are applied cy-près should be removed.

#### Cases (2) and (3): disclaimer and declarations

6.61 The disclaimer procedure (Case (2)) requires the donor actively to waive his or her right to have a donation returned, using the prescribed form. The declaration procedure (Case (3)) requires the donor actively to request the return of the donation. In the Consultation Paper, we said that neither is likely to be used in practice; they are likely to be administratively costly, and if trustees are aware of the procedures, they are likely also to discover the Charity Commission's recommended practice concerning the drafting of fundraising literature. If they follow that practice, neither process is likely to be necessary. We asked consultees whether the procedures remain of any use.

6.62 Consultees expressed a range of views as to whether the procedures should be removed or simplified, the majority thinking that they should be removed. Those who thought they should be retained tended to focus on the desirability of donors having an ability to restrict donations to particular purposes or an ability to disclaim an entitlement to the return of their donation. But, as other consultees pointed out, that would remain possible even if the disclaimer and declaration procedures were removed. Anthony Collins Solicitors LLP said that “the same result can be achieved (more transparently) by appropriately worded appeal literature”. Similarly, Bates Wells Braithwaite said that the procedures were “overly complicated” and if donors want to retain control over their donation, “they are more likely to put in place bespoke arrangements ... around restricted uses for the funds, rather than rely on these statutory procedures”.

6.63 Accordingly, the two procedures make specific, precise and detailed provision for something that can already be achieved under the current law.

- (1) There is no need for a prescribed form of disclaimer (Case (2)); if a donor responds to an offer of repayment simply by saying that he or she does not want the money, the funds can be applied *cy-près*.<sup>396</sup> We accept that the existence of a prescribed form might be helpful, but it can also cause confusion by suggesting that it is the only way to achieve the desired result. We think that it would be preferable for the Charity Commission's guidance on failed fundraising appeals to give advice as to how donors could disclaim any entitlement to repayment, rather than having such a precise statutory procedure.
- (2) Similarly, some consultees pointed out that the declaration procedure (Case (3)) might be useful. We agree, but the same result can be achieved by the fundraising literature, and again can be the subject of Charity Commission guidance. It is not, in fact, of particular assistance to donors since it can only be used if charities voluntarily fundraise on the basis of the qualifying solicitation. It would be preferable, in our view, for charities to have the freedom to fundraise on express terms which can be tailored to the charity and the appeal, rather than retain a straitjacketed statutory procedure.

6.64 We acknowledge that the disclaimer and declaration procedures are effectively enabling provisions; there is no obligation on trustees or donors to use them, and they might be helpful in some cases. We should therefore be cautious about removing them. But consultation has revealed that the procedures are rarely, if ever, used, and the same outcomes can be achieved without them. We think that, in the spirit of simplifying the law and focussing trustees' attention on making express tailored provision for failed appeals, the two procedures should be removed.

#### **Recommendation 12.**

6.65 We recommend that sections 63 to 66 of the Charities Act 2011, concerning the *cy-près* application of the proceeds of failed appeals, be simplified as follows.

- (1) Case (1) (the advertisement and inquiry requirements under section 63 of the Charities Act 2011) should be replaced with a requirement that the trustees take reasonable steps to contact donors in order to offer the return of their donations, such steps to be agreed in advance with the Charity Commission.
- (2) After proceeds of a failed appeal have been applied *cy-près* pursuant to Case (1), the six-month period in which donors can continue to make a claim for the return of their donations should be removed.
- (3) Case (2) (the disclaimer procedure in section 63(1)(b)) and Case (3) (the declaration procedure in section 65) should be repealed.

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<sup>396</sup> Either because the donor will effectively have indicated a general charitable intention or because the donor would be treated as re-donating the money for general charitable purposes.

6.66 Clause 6 of the draft Bill, inserting section 63A into the Charities Act 2011, would give effect to this recommendation.

Case (5): Charity Commission decision that it would be unreasonable to contact the donors

6.67 Our recommendations to allow donations up to £120 to be applicable cy-près, and to allow more flexible requirements for contacting donors, will remove much of the need for Case (5). In some cases, however, it might be difficult to locate donors even if their names are known (for example, a charity might only have records of a donor's name, with no other details that would allow the charity to trace them). Case (5) will remain as a residual power.

### **Failed appeals: summary**

6.68 In the case of a failed appeal, following implementation of our recommendations under Issues (A) and (B) above, the funds can be applied cy-près if:

- (1) the donation is small, that is, less than £120;
- (2) the trustees have taken reasonable steps, as agreed in advance with the Charity Commission, to contact the donors (a simplified Case (1));
- (3) the funds are raised through a cash collection or from a lottery, competition or other similar activity (Case (4)); or
- (4) the Charity Commission decides that it would be unreasonable to take steps to contact the donors (Case (5)).

6.69 We now turn to consider how those funds can be applied cy-près (Issue (C)). Unlike Issues (A) and (B), this issue is not limited to failed appeals; it also includes surplus cases.<sup>397</sup> Our discussion of Issue (C) therefore covers both failed appeals and surplus cases.

### **Issue (C): failed appeals and surplus funds – Charity Commission involvement**

6.70 Issue (C) concerns the making of cy-près schemes, once donations have become applicable cy-près either following a failed appeal (on which see Issues (A) and (B) above) or in a surplus case.

6.71 In the Consultation Paper, we asked whether – once funds have become applicable cy-près – trustees ought to be empowered to decide how the funds are applied rather than having to ask the Charity Commission for a cy-près scheme. We noted that small charities (with an annual income of £10,000 or less) had a power to change their purposes under section 275 by notifying the Commission, with a power for the Commission to object to the resolution.<sup>398</sup>

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<sup>397</sup> As we explained above, a cy-près scheme can be made by the Charity Commission in a surplus case without the need to show a general charitable intention, so the Charities Act 2011, ss 63 to 66 (and our recommended replacement section 63A) are irrelevant in such a case.

<sup>398</sup> Our recommendations in Ch 4 would see s 275 being repealed: see paras 4.28 and following; 4.116 and following; and 4.121(9).

- 6.72 We have already recommended that the requirement for a general charitable intention should be removed (and therefore a cy-près scheme could be made without having to take steps to contact the donors) in respect of donations of up to £120 to a failed appeal (see Issue (A) above). In the Consultation Paper, we said that on this approach, the trustees should be able to decide on the cy-près application of the funds without the involvement of the Charity Commission. We also said that trustees could be given a similar power in surplus cases.
- 6.73 The vast majority of consultees agreed that trustees should be permitted to decide on the cy-près application of funds that fell below the threshold under Issue (A). They also thought that trustees should have an equivalent power in surplus cases.
- 6.74 Most consultees went further and suggested that trustees should be able to decide on the cy-près application of small funds, whether arising from a failed appeal or a surplus case. They generally suggested that trustees should notify the Charity Commission of their decision and that the Commission should have a power to object, as under the powers in sections 275 and 282.<sup>399</sup> Consultees' suggestions for an appropriate fund value threshold ranged from £1,000 to £20,000. The proposal would avoid the need for trustees to obtain a cy-près scheme from the Commission. NCVO, ACF, CFG and IoF said it would remove an administrative burden for charities and the Charity Commission and give trustees "ownership and responsibility for deciding on the application of funds in line with their overall objective of furthering the best in interests of the charity".
- 6.75 In Chapter 4, we have made recommendations concerning changes to charities' purposes. We recommend that unincorporated charities be given a power to change their purposes by resolution without requiring a cy-près scheme, but subject nonetheless to obtaining the Charity Commission's consent to the change which should be guided by the section 67 similarity considerations (see paragraphs 4.121 and 4.139). In consequence, we recommend the removal of the section 275 power for small charities to change their purposes.<sup>400</sup>
- 6.76 Consistently with those recommendations, we think that the proceeds of failed appeals and surplus cases should be applicable to similar purposes by a resolution of the charity trustees (taking into account the section 67 similarity considerations, with some modification), rather than requiring a formal cy-près scheme.
- 6.77 Consultees tended to agree that, in general, the Charity Commission should have oversight of the cy-près application of funds. We agree; the Commission's oversight ensures that the trustees have, for example, taken appropriate steps to try to contact donors (where that is required) and it ensures that the alternative uses of the fund are sufficiently similar to the original purposes.<sup>401</sup>

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<sup>399</sup> See para 4.28 and following on section 275 and paras 8.40 and following on section 282.

<sup>400</sup> Para 4.121(9).

<sup>401</sup> Stone King LLP said that failed appeals and surplus cases are rare and therefore not a significant burden on the Charity Commission, whose oversight "means that trustees are far more focussed on getting the process right, and this should be maintained". Similarly, the CLA thought the Charity Commission's involvement in failed appeals and surplus cases was valuable because the law is complicated; "pushing decision-making in these cases onto trustees is likely to create issues that will be more costly and complicated for a charity to sort out in the long run".

6.78 But consultees generally thought that oversight by the Charity Commission was not necessary in respect of small funds or small donations. We have concluded that a power for the trustees to make the decision alone should be based on the size of the fund rather than the size of individual donations within a fund. Taking Stone King LLP's example in paragraph 6.41 above, it is more important that the Charity Commission oversees the use of the £10,000 fund than the £5,000 fund, despite the fact that the larger fund comprises individual donations of £10 whereas the smaller fund comprises individual donations of £1,000. The threshold should reflect the risk of trustees applying funds inappropriately; it should therefore be based on the size of the fund, not the constituent donations.

6.79 What should the threshold be? The CLA noted that the Charity Commission already permits failed appeals raising less than £1,000 from unidentifiable donors to be applied cy-près without a scheme,<sup>402</sup> and said it would be sensible to formalise this approach in legislation. As already noted, setting a threshold is inevitably arbitrary but, drawing on the views of consultees and the Charity Commission's existing practice, we have concluded that the threshold for trustees to be able to act alone should be set at £1,000. We think that the threshold should be capable of amendment by secondary legislation.

**Recommendation 13.**

6.80 We recommend that, where the proceeds from failed appeals and from surplus cases are applicable cy-près:

- (1) trustees should have a power to resolve that the proceeds be applied for new purposes, having regard to:
  - (a) the desirability of securing that the purposes are, so far as reasonably practicable, similar to the specific charitable purposes for which the proceeds were given; and
  - (b) the need for the purposes to be suitable and effective in the light of current social and economic circumstances;
- (2) if the proceeds exceed £1,000, such a resolution should only take effect when the Charity Commission consents to it; and
- (3) that financial threshold should be capable of amendment by way of secondary legislation.

6.81 Clause 7 of the draft Bill, inserting section 67A into the Charities Act 2011, would give effect to this recommendation.

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<sup>402</sup> See para 6.21 above.

# Chapter 7: Acquisitions, disposals and mortgages of charity land

## INTRODUCTION

- 7.1 In this chapter we consider the restrictions on charity trustees disposing of, or granting mortgages over, charity land.<sup>403</sup> The regime is complex and was considered by some consultees to be burdensome for charities. Broadly speaking, charities are required to obtain advice from a qualified surveyor (a member of the Royal Institution of Chartered Surveyors (“RICS”)) before disposing of any interest in land. Consultees generally agreed that it was desirable for charities to take advice on property matters from suitably qualified and experienced professionals. The key policy question is the extent to which charities should be compelled to obtain advice before disposing of charity land.
- 7.2 Gerald Eve LLP (surveyors) gave an example of a sale of charity land for £1.15 million that would have been made by the trustees for £1 million had the trustees not been required to obtain their advice. On the other hand, the National Trust reported that, over five years, it has made around 1,000 disposals of land and that in only two or three cases did the RICS surveyor’s report result in “significant added value”. To what extent should the law impose conditions in all cases to cater for those reportedly rare instances when trustees might dispose of land at an undervalue?
- 7.3 The regulation of disposals of charity land split consultees. Some argued strongly that the current requirements were indiscriminate and disproportionate, and that trustees should have flexibility to decide whether to obtain advice, what sort of advice, from whom, and at what stage. Others argued, equally strongly, that trustees can make mistakes when disposing of land and that they should therefore always obtain advice from a RICS surveyor in order to obtain the best terms<sup>404</sup> for the charity. The opposing arguments concerning whether and how the regime should be reformed are finely balanced.

### Structure and summary of this chapter

- 7.4 We start by articulating the concepts of powers and restrictions. We then look briefly at the historical background to transactions involving charity land before explaining the current regime, including the provisions that protect purchasers from the risk of transactions being void or voidable as a result of the current law. After summarising consultees’ diverse views, we make recommendations for reform. We do not recommend removing the existing requirements to obtain advice but instead make two

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<sup>403</sup> By “charity land”, we mean any land in England or Wales which is held by, or on trust for, a charity: Charities Act 2011, ss 117(1), 124(1) and 129(1). The definition therefore includes, for example, land owned beneficially by a charitable company, as well as land held on trust by the trustees of an unincorporated charity.

<sup>404</sup> The Charities Act 2011, s 119(1)(c), requires the charity trustees to be satisfied that the “terms” – and not the “price” – are the best that can reasonably be obtained for the charity, which recognises that the trustees might not simply be seeking the best price from the disposal of charity land; as we explain later, trustees might deliberately dispose of land at less than the “best price” that could be obtained.



principal recommendations; first, we recommend simplification of the detailed advice requirements, and second, we recommend expanding the category of professionals who are permitted to provide advice. Finally, we consider the special position of charities governed by the Universities and College Estates Acts 1925 and 1964.

### **Powers and restrictions**

7.5 In looking at the ability of charity trustees to acquire and dispose of land, we have to distinguish between trustees' powers to do so – without which, attempts to buy, sell or otherwise deal with land would be void – and restrictions upon the exercise of those powers. Such restrictions may be in the trust deed,<sup>405</sup> articles of association or other governing document of the charity, and are therefore particular to that charity; or they may be in statute and therefore of general application. Absent those restrictions, all dealings that are within the trustees' powers would be valid.<sup>406</sup> Where there are restrictions, failure to comply with them would – depending on their construction – have one of the following consequences.

- (1) A purported disposition may be void, in which case it is of no effect.
- (2) A disposition may be voidable, in which case it takes effect unless and until it is set aside, also known as being “avoided”.
- (3) Failure to comply may have no effect at all upon the validity of the disposition but may make the trustees liable for breach of trust.<sup>407</sup>

7.6 We present a brief account of the evolution of statutory restrictions as an aid to understanding the present position.

### **The historical background<sup>408</sup>**

7.7 Case law before the middle of the nineteenth century demonstrated a developing jurisprudence about charity trustees' powers to dispose of land and restrictions on those powers. The position that evolved was summarised in *Bayoumi v Women's Total Abstinence Educational Union Ltd*:

Subject to the terms on which the land had been conveyed to them, charitable corporations and charity trustees had power to sell, lease or mortgage charity land.

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<sup>405</sup> The power of trustees (in the strict sense) to dispose of land under s 6(1) of the Trusts of Land and Appointment of Trustees Act 1996 cannot be restricted by the trust deed in the case of charitable trusts: s 8(1) and (3). It can, however, be made subject to a condition that the trustees obtain consent to a disposition: s 8(2).

<sup>406</sup> Unless vitiated by anything within the general law, such as fraud or mistake.

<sup>407</sup> See *Fiduciary Duties of Investment Intermediaries* (2013) Law Commission Consultation Paper No 215, ch 6; *Donaldson v Smith* [2006] EWHC 1290(Ch), [2006] All ER (D) 293, at [54] and [55], by David Donaldson QC; *Snell's Equity* (33rd ed 2014) ch 10; Companies Act 2006, ss 39 to 42 (charitable companies); *Rosemary Simmons Memorial Housing Association Ltd v United Dominions Trust Ltd* [1986] 1 WLR 1440 (industrial and provident societies).

<sup>408</sup> For a detailed history of the power to dispose of, and restrictions on disposing of, charity land, see J Warburton, “Restrictions on Dispositions of Charity Property – Protection or Undue Burden?” in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 pp 125 to 145; and D Dennis, “Dispositions of charitable land” (2006) 70 *Conveyancer and Property Lawyer* 219.

But the transaction was liable to be set aside in equity unless it was shown to be beneficial to the charity.<sup>409</sup>

- 7.8 From 1855 onwards the position was made clearer by statute. The Charitable Trusts Amendment Act 1855 prohibited charity trustees from disposing of land that formed part of the charity's endowment without the consent of Parliament, the court or the Charity Commissioners.<sup>410</sup> The restriction was introduced owing to concerns about trustees entering into land transactions that were not in the charity's interests.<sup>411</sup>
- 7.9 The restriction imposed by the 1855 Act remained unchanged for over a century. The Charities Act 1960 modified it so that it applied only to "permanent endowment" and "functional land", rather than to the entirety of a charity's endowment.<sup>412</sup> As a result, the requirement to obtain consent from the court or Charity Commission no longer applied to the disposal of land which had been purchased using expendable funds and which was not occupied by the charity.
- 7.10 More significant, however, was the Charities Act 1992, which extended but also relaxed the restriction in the 1960 Act.<sup>413</sup> The 1992 Act extended the restriction to all land held by, or on trust for, a charity; it was no longer limited to permanent endowment and functional land. It relaxed the restriction by introducing certain procedures that charity trustees could follow to avoid having to obtain the consent of the Charity Commission or court to disposals of, or mortgages over, charity land. In the case of disposals or long leases of charity land, the procedure required the charity trustees to obtain advice from a RICS surveyor.<sup>414</sup> For mortgages or short leases, the procedure involved less stringent requirements to obtain advice.
- 7.11 The provisions of the 1992 Act concerning charity land were re-enacted in the Charities Act 1993,<sup>415</sup> were subject to minor amendments in the Charities Act 2006, and were consolidated in the Charities Act 2011.<sup>416</sup> Broadly speaking, the provisions introduced

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<sup>409</sup> [2003] EWCA Civ 1548, [2004] Ch 46, 54, by Chadwick LJ.

<sup>410</sup> Charitable Trusts Amendment Act 1855, s 29. The restriction did not apply to exempt charities, which included certain universities and cathedrals, nor to what came to be called "plain charities" which were charities maintained by voluntary contributions and not by endowment income. Special provision was made for "mixed charities", which had both income from endowment and income from voluntary contributions.

<sup>411</sup> *Re Mason's Orphanage and London and North Western Railway Co* [1896] 1 Ch 596, 605, by Kay LJ.

<sup>412</sup> The restriction was slightly different in its application to permanent endowment and functional land: Charities Act 1960, s 29. Permanent endowment was first defined in the Charities Act 1960, s 45(3), and the definition remains almost unchanged today: Charities Act 2011, s 353(3); see further Ch 8 below. "Functional land" was defined by s 29(2) of the Charities Act 1960 as land held by, or in trust for, a charity which "has at any time been occupied for the purposes of the charity".

<sup>413</sup> For the background to the provisions of the Charities Act 1992 concerning land, see Report of the Charity Commissioners for England and Wales for the year 1986 (6 May 1987) paras 30 and 31; Sir Philip Woodfield, *Efficiency Scrutiny of the Supervision of Charities* (1987), part 9; Report of the Charity Commissioners for England and Wales for the year 1987 (18 May 1988) paras 51 to 55, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/235847/0427.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/235847/0427.pdf); and Charities: A Framework for the Future White Paper (1988/89) Cm 694, ch 7.

<sup>414</sup> These were the procedures that the Charity Commission required charity trustees to follow before granting consent under the Charities Act 1960.

<sup>415</sup> Charities Act 1993, s 36 and following.

<sup>416</sup> Charities Act 2011, s 117 and following.

by the 1992 Act still apply today, and are explained in detail below. As can be seen, therefore, whilst the current regime has been criticised as being burdensome, it is in fact the result of deregulation over time.

## THE CURRENT REGIME: LIMITATIONS ON DISPOSALS AND MORTGAGES

7.12 The current regime concerning charity land is set out in Part 7, sections 117 to 129, of the Charities Act 2011 (“Part 7”). There are separate provisions for disposals of charity land and for mortgages of charity land. The regime applies to both corporate and unincorporated charities. Failure to comply with the regime, where it applies, renders a disposition void.<sup>417</sup> Purchasers may, however, be protected in the event that a disposition is void.<sup>418</sup>

### Transactions to which the regime applies

7.13 Any disposal<sup>419</sup> of charity land<sup>420</sup> falls within the regime unless it is:

- (1) a disposal authorised by a statutory provision or scheme;<sup>421</sup>
- (2) a disposal for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925;<sup>422</sup>

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<sup>417</sup> *Bayoumi v Women’s Total Abstinence Educational Union Ltd* [2003] EWCA Civ 1548 [2004] Ch 46, [28], [29] and [43].

<sup>418</sup> Paras 7.37 to 7.45 below.

<sup>419</sup> Section 117(1) refers to a transaction under which land is to be “conveyed, transferred, leased or otherwise disposed of”. Examples include: sale; the grant of a lease over charity land; the grant, transfer or surrender of an easement, such as a right of way; the release of a restrictive covenant, such as an obligation not to build on land; the surrender of a lease; and an exchange of land.

<sup>420</sup> See 403 above. It is generally accepted that the land must be held by or in trust *exclusively* for a charity or charities so the regime does not apply where land is held jointly by a charity and a non-charity: T Dumont and F Wilson, “When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors” [2004] *Private Client Business* 118, 122. See paras 7.63, 7.64 and 7.177 and following below.

<sup>421</sup> Charities Act 2011, s 117(3)(a). For example, a disposal pursuant to a compulsory purchase order. We discuss sales by liquidators, administrators, receivers and mortgagees in paras 7.247 to 7.250 below. The Colleges of the University of Cambridge told us that when they exercise powers in their governing documents (or “statutes”; see Consultation Paper, Fig 7 (pp 60-61)) to dispose of land, the transaction falls within s 117(3)(a) since the statutes were made under the statutory procedure in the Universities of Oxford and Cambridge Act 1923 and are therefore, indirectly, authorised by a statutory scheme. They further believe (and the Charity Commission has agreed) that, even in the absence of the exception in section 117(3)(b), disposals that are made under the powers in the Universities and College Estates Act 1925 (with or without the Minister’s consent) also fall within the s 117(3)(a) exception. It is possible that dispositions which are authorised by Church of England Measures would fall under s 117(3)(a), given that Measures have the same force and effect as an Act of Parliament: see *Tudor on Charities* (10th ed 2015) p 788. The Church Commissioners have suggested examples of provisions which would provide sufficient authorisation such as s 4 of the Parsonages Act 1865 and s 92 of the Mission and Pastoral Measure 2011. However, they do not expand on why those particular provisions are sufficient: Church Commissioners, *Parsonages and Glebe Diocesan Manual* (2012), p 184.

<sup>422</sup> Charities Act 2011, s 117(3)(b). The Universities and College Estates Act 1925 applies to the Universities of Oxford, Cambridge and Durham, their constituent colleges and halls, Winchester and Eton. The 1925 Act includes powers for them to dispose of land. We consider the 1925 Act in more detail in paras 7.265 and following below.

- (3) a disposal to another charity “otherwise than for the best price that can reasonably be obtained” which is authorised by the transferor charity’s trusts;<sup>423</sup>
- (4) a lease to a beneficiary of the charity “granted otherwise than for the best rent that can reasonably be obtained” and intended to enable the premises to be occupied for the charity’s purposes;<sup>424</sup>
- (5) a disposal of land held by or in trust for an exempt charity;<sup>425</sup>
- (6) a disposal of an advowson;<sup>426</sup>
- (7) the release of certain rentcharges;<sup>427</sup> or
- (8) a disposal of glebe land or certain other ecclesiastical property.<sup>428</sup>

7.14 Any mortgage or other security over charity land falls within the regime unless it is:

- (1) authorised by a statutory provision or scheme;
- (2) a mortgage for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925;
- (3) a mortgage granted by an exempt charity;<sup>429</sup> or
- (4) a mortgage of glebe land or certain other ecclesiastical property.<sup>430</sup>

### **The default rule: no transaction without the consent of the court or the Charity Commission**

7.15 The default rule is that charity trustees cannot proceed with a transaction that falls within the regime unless they have obtained an order from the court or the Charity Commission authorising them to do so.<sup>431</sup> But the default rule does not apply if certain requirements are met. The requirements differ depending on whether or not the proposed transaction is a mortgage.

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<sup>423</sup> Charities Act 2011, s 117(3)(c). A disposal to another charity will not fall within this exception if it is at open market value. We discuss this exception in paras 7.253 to 7.260 below.

<sup>424</sup> Charities Act 2011, s 117(3)(d). We discuss this exception in paras 7.261 and 7.262 below.

<sup>425</sup> Charities Act 2011, s 117(4)(a). We give some examples of exempt charities in para 2.15.

<sup>426</sup> Charities Act 2011, s 117(4)(c). An advowson is “the perpetual right of presentation to an ecclesiastical living”: *Megarry & Wade, The Law of Real Property* (8th ed 2012) para 31-007.

<sup>427</sup> Charities Act 2011, s 127. A rentcharge is “an annuity secured on some specified land”: *Megarry & Wade, The Law of Real Property* (8th ed 2012) para 31-005.

<sup>428</sup> Charities Act 2011, s 10(2). See Glossary for definition of Diocesan glebe land.

<sup>429</sup> Charities Act 2011, s 124(9) and (10).

<sup>430</sup> See n 427.

<sup>431</sup> Charities Act 2011, ss 117(1) and 124(1). This is the restriction that was first introduced by the 1855 Act. Whilst a charity can, in theory, obtain an order from the court, the restrictions in the Charities Act 2011, s 115, on charities taking court proceedings where a matter can be dealt with by the Charity Commission effectively prevent such a course: see generally Ch 15.

## **(A) Dispositions other than mortgages**

7.16 Where the transaction is not a mortgage, charity trustees<sup>432</sup> are not required to obtain an order from the court or the Charity Commission if the disposal of land satisfies two conditions,<sup>433</sup> namely:

- (1) the disposition is made to a person who is not a “connected person”, or a trustee or nominee for a connected person (“Condition 1”); and
- (2) the charity trustees obtain and consider advice on the disposition (“Condition 2”). The advice required differs depending on whether the disposition is a lease for a term of seven years or less which is not granted in consideration of a premium (“a short lease”) or any other disposition;<sup>434</sup> less stringent requirements apply to the former than the latter.

7.17 There are further requirements where the disposal is of “designated land”. In the text that follows we discuss connected persons, the advice requirement, and the additional rules for designated land.

Condition (1): connected persons

7.18 A connected person is someone who falls into the following list at the time of the disposition itself, or any contract for the disposition:<sup>435</sup>

- (1) a charity trustee<sup>436</sup> of the disposing charity or “a trustee for the charity”;<sup>437</sup>
- (2) a person who is the donor of any land to the charity (whether on or after the establishment of the charity);
- (3) a child,<sup>438</sup> parent, grandchild, grandparent, brother or sister of any such trustee or donor;
- (4) an officer, agent or employee of the charity;
- (5) the spouse or civil partner of any person falling within (1) to (4);<sup>439</sup>
- (6) a person carrying on business in partnership with any person within (1) to (5);

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<sup>432</sup> The requirements remain the same where the land has been vested in the Official Custodian for Charities; see generally ss 90 and 91 of the Charities Act 2011.

<sup>433</sup> Charities Act 2011, s 117(2).

<sup>434</sup> Charities Act 2011, ss 119 and 120.

<sup>435</sup> Charities Act 2011, s 118(2).

<sup>436</sup> That is, a “charity trustee” within the meaning of s 117: see Glossary.

<sup>437</sup> A “trustee for the charity” would include a holding trustee who would not fall within the definition of “charity trustee” since a holding trustee does not have general control and management of the charity: Charities Act 2011, s 177.

<sup>438</sup> Including a stepchild: Charities Act 2011, s 350(1).

<sup>439</sup> Cohabitants are treated as spouses or civil partners for the purposes of this provision under Charities Act 2011, s 350(2).

- (7) an institution controlled by anyone within (1) to (6), or by two or more of them;<sup>440</sup>
- (8) a body corporate in which a substantial interest is held by anyone within (1) to (7), or by two or more of them.<sup>441</sup>

Condition (2): advice requirements

7.19 The second condition under section 117(2) is that the charity trustees have obtained advice. The advice requirements are set out in sections 119 and 120.

*Section 119: Dispositions other than short leases*

7.20 Section 119(1) applies to dispositions other than the grant of a short lease,<sup>442</sup> and requires that, before entering into an agreement for the sale, lease or disposal of the land, the charity trustees must:

- (1) obtain and consider a written report on the proposed disposition from a qualified surveyor instructed by the trustees and acting exclusively for the charity;
- (2) advertise the proposed disposition for such period and in such manner as is advised in the surveyor's report, unless the report advises that it would not be in the best interests of the charity to advertise it; and
- (3) decide that they are satisfied, having considered the surveyor's report, that the terms on which the disposition is proposed to be made are the best that can reasonably be obtained for the charity.<sup>443</sup>

7.21 A qualified surveyor is "a fellow or professional associate of the Royal Institution of Chartered Surveyors" who is "reasonably believed by the charity trustees to have ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question".<sup>444</sup>

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<sup>440</sup> See Charities Act 2011, s 351: "a person controls an institution if the person is able to secure that the affairs of the institution are conducted in accordance with the person's wishes".

<sup>441</sup> A "substantial interest" in a body corporate is held by a person who "(a) is interested in shares comprised in the equity share capital of that body of a nominal value of more than one-fifth of that share capital, or (b) is entitled to exercise, or control the exercise of, more than one-fifth of the voting power at any general meeting of that body": Charities Act 2011, s 352(1). The rules for interpretation (for example, of the concept of being interested in shares) set out in sch 1 to the Companies Act 2006 also apply: Charities Act 2011, s 352(2).

<sup>442</sup> See para 7.16(2) above.

<sup>443</sup> As explained in n 404 above, non-financial considerations might be relevant.

<sup>444</sup> Charities Act 2011, s 119(3). The RICS has members as well as fellows and professional associates. The Charity Commission states that members of RICS also fall within this definition: Charity Commission, *Sales, leases, transfers or mortgages: What trustees need to know about disposing of charity land (CC28)* (March 2012), para 4.3, available at <https://www.gov.uk/government/publications/sales-leases-transfers-or-mortgages-what-trustees-need-to-know-about-disposing-of-charity-land-cc28>. We refer to this guidance as "CC28". The Secretary of State has power under s 119(3)(a) to make regulations to widen this group beyond RICS. Whilst there has been a consultation on widening the group (discussed in para 7.134), no regulations have been made.

7.22 The qualified surveyor's report must comply with the Charities (Qualified Surveyors' Reports) Regulations 1992 ("the 1992 Regulations"),<sup>445</sup> which require numerous matters to be addressed: see Figure 12.

**Figure 12: the Charities (Qualified Surveyors' Reports) Regulations 1992**

A qualified surveyor's report must address the following points:

- (1) a description of the land and its location, to include measurements, current use, number of buildings included, measurements of buildings, number of rooms in buildings and their measurements; a plan (not necessarily to scale) may be used;
- (2) whether the land or part of it is leased by or from the charity trustees, and details of any lease (length, period outstanding, rent, service charge, rent or service charge review provisions, liability for rent and dilapidations, any other lease provision affecting value);
- (3) whether the land is burdened or benefited by any easement or restrictive covenant, or is subject to any annual or other periodic sum charged on or issuing out of the land except rent reserved by a lease or tenancy;
- (4) whether any buildings are in good repair, and if not the surveyor's advice as to whether it would be in the charity's best interests to repair them, what the repairs should be and the estimated cost;
- (5) if the surveyor considers that it would be in the charity's best interests to alter buildings before disposition, a note of that opinion and an estimate of the cost;
- (6) advice as to the manner of disposing of the land so that the terms on which it is disposed of are the best that can reasonably be obtained for the charity, including the possibility of dividing the land, advertising period and manner or reasons why the surveyor does not think it would be in the charity's best interests to advertise, and any view on whether it would be best to delay the disposition or not;
- (7) VAT advice, if relevant and the surveyor feels able to give it (and if not, a statement to that effect);
- (8) the current value of the land in present circumstances, or possible rent under a lease, and its value if advice, opinions and recommendations given are followed; and
- (9) if the surveyor considers that the proposed disposition is not in the best interests of the charity because it does not make the best use of the land, his opinion to that effect and reasons, plus advice on which disposition would constitute best use.

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<sup>445</sup> SI 1992 No 2980.

*Section 120: short leases*

7.23 Section 120 applies when the proposed disposition is a short lease,<sup>446</sup> and requires that, before entering into an agreement for the lease, the charity trustees must:

- (1) obtain and consider advice on the proposed lease from a person who is reasonably believed by the trustees to have the requisite ability and practical experience to provide them with competent advice on the proposed lease; and
- (2) decide that they are satisfied, having considered the advice, that the terms of the proposed lease are the best that can reasonably be obtained for the charity.<sup>447</sup>

*Differences between the requirements of sections 119 and 120*

7.24 The main differences between the advice requirements for dispositions under section 119 and for short leases under section 120 are therefore:

- (1) section 119 requires a qualified surveyor, section 120 does not – for example, an estate agent may suffice;
- (2) section 119 requires advertising (unless the surveyor advises it is not in the best interests of the charity), section 120 does not; and
- (3) section 119 requires a written report with specified content, section 120 does not.

*Designated land: additional restrictions*

7.25 Section 121 of the Charities Act 2011 imposes additional requirements where land is held by or in trust for a charity, and “the trusts on which it is held stipulate that it is to be used for the purposes, or any particular purposes, of the charity”. This is known as “designated land”<sup>448</sup> or “specie land”.<sup>449</sup>

7.26 Section 121(2) requires the charity trustees to invite representations before the disposition is made, by taking the following steps:

- (1) they must give public notice of the proposed disposition, inviting representations to be made within a time specified in the notice (not less than one month from the date of the notice); and

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<sup>446</sup> See para 7.16(2).

<sup>447</sup> Charities Act 2011, s 120(2).

<sup>448</sup> “Designated land” is also defined in s 275 of the Charities Act 2011 for the purposes of that section (resolution to replace the purposes of an unincorporated charity); for a discussion of s 275, see para 4.28 and following. The definition in s 275 is, in substance, the same as that in s 121.

<sup>449</sup> CC28, para 1.6. The Charity Commission distinguishes designated or specie land from “functional property”, which is property “used by the charity to further its charitable objects but is not *required* to be used in this way by the trusts of the charity” (emphasis in original): Charity Commission, *OG54 B3 Disposals of Charity Interests in Property* (March 2012) para 1.1, now archived and available at [http://webarchive.nationalarchives.gov.uk/+http://www.charitycommission.gov.uk/about\\_us/ogs/g054b003.aspx](http://webarchive.nationalarchives.gov.uk/+http://www.charitycommission.gov.uk/about_us/ogs/g054b003.aspx).



- (2) they must take into consideration any representations made to them within that time about the proposed disposition.<sup>450</sup>

7.27 The additional requirements in section 121 do not apply where:

- (1) the disposition is made with a view to acquiring replacement property to be held on the relevant trusts;<sup>451</sup> or
- (2) the disposition is the granting of a lease for a term ending not more than two years after it is granted, and not granted wholly or partly in consideration of a premium.<sup>452</sup>

7.28 The Charity Commission can make directions granting exemption from the designated land restrictions in section 121. Exemption may be granted in respect of a specific disposition, or of dispositions (generally, or by reference to a specific class) by a charity or class of charity.<sup>453</sup> An application for a direction must be made by the charity or charities in question, and the Charity Commission must be satisfied that giving a direction would be in the interests of the charity or charities.<sup>454</sup> As Luxton notes:

The aim of this saving is to make life less difficult for charities which make many dispositions of functional land each year. The paradigm case is the National Trust, which has some 10,000 properties leased out on relatively short leases ... . The subsection enables the Charity Commissioners to make appropriate directions to relieve it, or charities in a similar position, of the burden of having to serve thousands of public notices each year.<sup>455</sup>

7.29 Disposing of designated land with no intention to replace it, with the result that it will not be possible to carry on the purposes for which the land was held after the disposal, would require a cy-près scheme from the Charity Commission.<sup>456</sup> The Charity Commission gives the example of an almshouse charity wishing to sell its almshouses and to use the proceeds to relieve poverty in other ways.<sup>457</sup> A cy-près scheme is not required for a small disposal which has no impact on the charity's ability to further its objects; but if ownership of the land is central to fulfilling the charity's purposes, or if there is a surplus left over, the charity will require a cy-près scheme<sup>458</sup> to apply those funds to some other purpose.

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<sup>450</sup> Charities Act 2011, s 121(2). These steps must precede "the relevant time", that is the time when the charity trustees enter into the agreement for the disposition, or if they do not do so, the time of the disposition: Charities Act 2011, s 121(2) and (4).

<sup>451</sup> The Charity Commission provides guidance on replacing designated land in CC28, para 5.9.

<sup>452</sup> Charities Act 2011, s 121(5).

<sup>453</sup> Charities Act 2011, s 121(6).

<sup>454</sup> Charities Act 2011, s 121(7).

<sup>455</sup> P Luxton, *The Law of Charities* (2001) para 17.73.

<sup>456</sup> Following implementation of our recommendations in Ch 4, such a disposal will continue to require the Charity Commission's consent to a change of purposes but will no longer require a cy-près scheme.

<sup>457</sup> CC28, p 17.

<sup>458</sup> Or, following implementation of our recommendations in Ch 4, an authorised change of purpose.

## Obtaining a Charity Commission order to authorise a disposal

7.30 When Condition (1) or Condition (2) cannot be met, the charity trustees must obtain the consent of the Charity Commission to the disposal. In some cases the Charity Commission will consider making an order authorising a disposition even though the charity could satisfy Condition (2) by obtaining a surveyor's report.<sup>459</sup> The guidance suggests that authorisation will be possible in three cases:<sup>460</sup>

- (1) the cost of obtaining a surveyor's report is "out of all proportion" to the value of the land, and the value of the transaction is genuinely low;<sup>461</sup>
- (2) "the land is in a remote area where it may be difficult to find a qualified surveyor with sufficient knowledge of local land values"; the Charity Commission would look for an estate agent's report to be obtained instead; and
- (3) transactions at an undervalue which do not fall within the existing exemption.<sup>462</sup>

## (B) Mortgages

7.31 Where the transaction is a mortgage, the charity trustees are not required to obtain an order from the court or the Charity Commission if the mortgage is executed after they have obtained and considered written advice on the mortgage.<sup>463</sup>

7.32 There is no separate condition that the mortgagee must not (without the consent of the Charity Commission) be a connected person. However, the charity trustees' fiduciary duties<sup>464</sup> would be likely to prevent them from granting a mortgage to a connected person.

## Matters on which the charity trustees must obtain advice

7.33 Where the mortgage is to secure the repayment of a proposed loan or grant,<sup>465</sup> the trustees must be advised on:

- (1) whether the loan or grant is necessary in order for the charity trustees to be able to pursue the particular course of action in connection with which they are seeking the loan or grant;

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<sup>459</sup> See P Luxton, *The Law of Charities* (2001) para 17.26, explaining that since the procedure was introduced to shift regulatory resources away from these transactions, charities are expected to use it rather than making unnecessary applications.

<sup>460</sup> In deciding whether to grant authorisation under Part 7, the Charity Commission will ask for information about: (1) the value of the land and how it has been assessed; (2) advertising; and (3) why the charity needs an order. The Commission will also request minutes of the meetings at which decisions about the disposal were taken: CC28, para 5.5 and following.

<sup>461</sup> For example, disposals of wayleaves (licences, or permissions, to do something or keep something on land) similar to other such disposals recently certified to be of low value.

<sup>462</sup> In Charities Act 2011, s 117(3)(c); see para 7.13(3). For example, a disposal to a public authority rather than a charity.

<sup>463</sup> Charities Act 2011, s 124(2).

<sup>464</sup> For further detail on trustees' duties see Ch 9.

<sup>465</sup> The terms of a grant might require it to be repaid if it is given subject to particular conditions that are not satisfied. Grant-making bodies may, therefore, require charities to grant a mortgage over their land as security for the charity's obligation to repay the grant in the event that the conditions of the grant are not satisfied.

- (2) whether the terms of the loan or grant are reasonable having regard to the status of the charity as its prospective recipient; and
- (3) the ability of the charity to repay on those terms the sum proposed to be paid by way of loan or grant.

7.34 If the mortgage is to secure the discharge of any other proposed obligation, the trustees must be advised as to whether it is reasonable for the charity trustees to undertake to discharge the obligation, having regard to the charity's purposes.<sup>466</sup>

7.35 The person who advises on the above matters must:

- (1) be someone reasonably believed by the charity trustees to be qualified by ability in and practical experience of financial matters; and
- (2) not have any financial interest in relation to the loan, grant or other transaction in question.

7.36 The legislation states that the person may be someone giving the advice in the course of their employment as an officer or employee of the charity or of the charity trustees.<sup>467</sup>

### **Formalities and land registration**

Failure to comply with the requirements of the current regime

7.37 As we mentioned above, failure to comply with the requirements of Part 7 of the Charities Act 2011 renders the disposition – be it a transfer, lease, mortgage or any other arrangement – void.<sup>468</sup> If a disposition is void, it is of no effect. That would have serious consequences for purchasers from charities. The Charities Act 2011 therefore contains provisions designed to safeguard purchasers of land from charities against that risk. The same provisions also protect purchasers from the risk that the transaction will be rendered void or voidable because of non-compliance with any other restrictions on the trustees' powers, in the trust deed or other governing document of the charity.

The conveyancing procedure

7.38 Sections 122 and 123 of the Charities Act 2011 ensure that those who need to know whether Part 7 applies to the transaction are informed of the position; more importantly, they provide that any restrictions on the trustees' powers – not only in Part 7 but also elsewhere – are deemed to have been complied with when the trustees so certify. The workings of the conveyancing provisions are best understood if we begin with acquisition.

7.39 When land is acquired by a charity – whether by purchase, gift or assent – the transfer or other document is required to state that the land is going to be held by a charity as a result of the disposition. This is the case whether the charity is an exempt charity, and

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<sup>466</sup> Charities Act 2011, s 124(3) and (4). Advice on these matters must also be taken if, after the mortgage has been entered into, the trustees are to enter into any transaction for payment of further sums or undertaking further obligations, whose repayment or discharge is also secured by the mortgage

<sup>467</sup> Charities Act 2011, s 124(8).

<sup>468</sup> We explain the effect of a transaction being void in para 7.5.

(if it is not exempt) whether the requirements of Part 7 will apply to any disposal of the land.<sup>469</sup> The result of that statement is that when the acquisition is registered (whether or not that is a first registration<sup>470</sup>) HM Land Registry will enter a restriction on the register of title if Part 7 applies. The effect of the restriction is that no future disposition of the land by the charity will be registered unless the requirements of Part 7 have been met.<sup>471</sup>

- 7.40 Accordingly, a disposition of charity land to which Part 7 applies – whether a sale, a mortgage, or any other relevant disposition – will be controlled by the restriction. The restriction alerts a future purchaser to the requirements of the statute and to the need to ensure that the transfer, lease or other instrument is in a form on which he or she can rely. However, the purchaser is not required to check that an order of the Charity Commission or of the court has been made, or that advice has in fact been given in accordance with the requirements of sections 119, 120 or 124.<sup>472</sup>
- 7.41 Instead, the transfer, mortgage or other disposition that triggers Part 7, and any contract for such a disposition, must state that the land is charity land, whether the charity is an exempt charity, and whether the Part 7 requirements apply.<sup>473</sup> If they do, the trustees must certify in the transfer, mortgage or other deed that they have power under the trusts of the charity to effect the disposition and that the requirements of Part 7 have been complied with.<sup>474</sup> Where that certificate is given it is conclusively presumed, in favour of a purchaser,<sup>475</sup> to be true.<sup>476</sup>

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<sup>469</sup> Charities Act 2011, s 122(7) and (8); if the acquisition is of registered land or will trigger first registration the statement must be in the form prescribed by Land Registration Rules 2003: Charities Act s 123(1).

<sup>470</sup> It is difficult to conceive of situations today where the acquisition of unregistered land by a charity for a freehold or leasehold estate – save for leases of seven years or less – will not trigger first registration: Land Registration Act 2002, s 4.

<sup>471</sup> If a charity, after being registered as the proprietor of land, becomes an exempt charity, or an exempt charity ceases to be such, the charity trustees must apply for an appropriate alteration to the register. They must also apply for a restriction if a landowner declares a trust over registered land in favour of a charity. See Charities Act 2011, s 123 (3), (4) and (5).

<sup>472</sup> Although see the discussion in para 7.224 and following below concerning the position of a purchaser in the window between contract and conveyance.

<sup>473</sup> Charities Act 2011, ss 122(2) and 125(1). Note that this means that although exempt charities do not have to comply with the requirements of Part 7, they must comply with the requirement to make this statement. In registered land the statement is technically unnecessary because the same information can be found by checking whether there is a restriction on the trustees' title. If there is no restriction on the title, the registered proprietor's "right to exercise owner's powers in relation to a registered estate or charge is to be taken to be free from any limitation affecting the validity of a disposition": Land Registration Act 2002, s 26. So in the absence of a restriction the purchaser of registered land need not be concerned about Part 7 of the 2011 Act.

<sup>474</sup> Whether by an order of the court or the Charity Commission, or by compliance with the advice requirements: Charities Act 2011, ss 122(3) and 125(2).

<sup>475</sup> Anyone who acquires an interest in the land for money or money's worth: see Charities Act 2011, ss 123(4) and 125(3).

<sup>476</sup> Charities Act 2011, ss 122(4) and 125(3). Section 125(6) and (7) contains corresponding provision concerning the certificate given in respect of further advances under an existing mortgage.

- 7.42 That presumption means that when the disposition is registered, the registrar can be satisfied that the restriction has been complied with and will register the disposition; it also protects the purchaser from any later finding that the disposition was void.
- 7.43 Where the charity is disposing of unregistered land, the mechanism of the restriction is absent. Instead, the purchaser on examining the charity's title deeds (prior to buying the land or taking a mortgage) will often be aware of the need for the trustees to comply with the requirements of Part 7;<sup>477</sup> again, if a certificate is given in the transfer<sup>478</sup> (or mortgage, lease, or other deed) then the purchaser is protected.
- 7.44 Section 122(6) adds a further protection: if the certificate is not given, the requirements of Part 7 are nevertheless deemed to have been complied with in favour of a purchaser in good faith. This is most likely to be relevant where the charity is disposing of unregistered land. It is unlikely to be relevant in registered land because the restriction ensures that the transaction will not be registered unless the certificate is given, and accordingly the purchaser will not enter into a contract to purchase the land unless the contract includes an obligation on the charity to provide a certificate in the transfer.<sup>479</sup> If the registered title does not contain a restriction, a purchaser is already protected since he or she is entitled to assume that there is no limitation on the registered proprietor's powers.<sup>480</sup>
- 7.45 The system is thus designed (i) to protect purchasers, and (ii) (because of the form of the protection, given by the making of statements and certificates) to alert charity trustees to their duties. It does not in fact ensure compliance with those duties; the purchaser is protected even if the certificate is false. And, as noted above, the protection given to purchasers encompasses not only compliance with Part 7 but also compliance with any other restrictions on the trustees' powers since the certificate has to state that the trustees have power under the trusts of the charity to effect the disposition. It is to charities' benefit that purchasers are not wary of dealing with charities by reason of potential invalidity of transactions with them.

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<sup>477</sup> Either (a) by noting the statement made on acquisition (see para 7.39, but such a statement will only have been made in the case of acquisitions that post-dated the Charities Act 1992) or (b) by noting any declaration of charitable trust on the face of the conveyance to the charity. If the purchaser is not aware, and so does not obtain a certificate from the trustees, he or she may still be protected: see para 7.44.

<sup>478</sup> We say "transfer" rather than conveyance because the disposal will trigger first registration and so the form used will be a transfer.

<sup>479</sup> If the transfer itself, in which the certificate is given, is forged then the disposition will be void at common law but will confer a good title upon the purchaser once registered: Land Registration Act 2002, s 58, subject to the provisions for alteration and rectification in Sch 4 to the Land Registration Act 2002. The purchaser may lose title because of the forgery but will not necessarily do so; at any rate, that will be as a result of the forgery of the disposition and not related to the requirements of Part 7.

<sup>480</sup> Land Registration Act 2002, s 26; see n 473.

## EVALUATION OF THE CURRENT LAW

7.46 We summarised the advantages and disadvantages of the Part 7 regime in the Consultation Paper.<sup>481</sup> Consultees' views concerning those advantages and disadvantages were split, and we summarise them below.<sup>482</sup>

### Criticisms of the Part 7 regime

7.47 Bircham Dyson Bell LLP said that Part 7 "is more often than not seen as interfering with, rather than enabling, the proper management of a land transaction"; it is "bureaucratic and unnecessary". Consultees' criticisms of the Part 7 regime can be seen to fall into 11 categories.

#### (1) Costs and delay

7.48 Disposals other than mortgages require a report from a RICS surveyor addressing the numerous matters in the 1992 Regulations. Consultees told us that, in the case of fairly standard property transactions, reports generally cost between £400 and £2,000. For charities involved in numerous land transactions, the costs of surveyors' reports and legal costs of complying with Part 7 are large. Cancer Research UK thought that £100,000 was a reasonable estimate of its annual compliance costs, which is "out of all proportion to the risks involved".

7.49 A common criticism amongst consultees was of the need to obtain a surveyor's report when the cost of a report is disproportionate to the low value of the transaction, such as the grant of an easement or the sale of a small strip of land.<sup>483</sup> Sustrans and Railway Paths said that a report costing £300 established that a small piece of disused railway land was worth £100. The Landmark Trust said that a report costing £500 was necessary when its neighbours wished to extend septic tank soakaways over its land for £2,000.

#### (2) No added value

7.50 Consultees said that a report is often obtained, with the associated expense and delay, "once a deal has all but been agreed" so constitutes "an expensive box ticking exercise".<sup>484</sup> The report will often "simply repeat an estate agent's valuation".<sup>485</sup> For example, when property is left to charity by will, the personal representatives often accept an offer to purchase the property, but then a RICS report has to be obtained confirming that the offer reflects the market value of the property. We discuss legacy cases (where a charity is left property in a person's will) in more detail below.<sup>486</sup>

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<sup>481</sup> Consultation Paper, paras 8.37 to 8.58.

<sup>482</sup> For a more detailed summary, see Analysis of Responses, Ch 8.

<sup>483</sup> Consultees reported that it was difficult to persuade the Charity Commission to make an order dispensing with the advice requirements, and the process takes a long time, so charities will often prefer to incur the disproportionate costs of a report so as to avoid having to engage with, and wait for, the Charity Commission.

<sup>484</sup> The National Trust.

<sup>485</sup> Legacy Link.

<sup>486</sup> See paras 7.59 and following and 7.163 and following.

### (3) The adviser

- 7.51 Reports must be obtained from RICS surveyors, who are experts in land management and development. They are qualified, must comply with professional standards, and are regulated. Consultees, however, commented that advice from a RICS surveyor may not always be necessary. In the case of a residential property, for example, a local estate agent might be best placed to advise on a marketing strategy and on value.
- 7.52 There is some confusion as to whether advice can be provided by a RICS surveyor who is also a trustee or employee of the charity. In the case of a mortgage, the Charities Act provides that advice can be given by a person “in the course of their employment as an officer or employee of the charity or the charity trustees”.<sup>487</sup> However, there is no equivalent provision for dispositions other than mortgages which has raised doubts about whether an officer or employee of the charity can provide advice in these cases. Subject to managing conflicts of interest, consultees said that there is no reason why officers or employees should not provide such advice, and during consultation we were told that, in some charities, advice is regularly obtained from staff.

### (4) Indiscriminate application of the requirements

- 7.53 Consultees criticised Part 7 for being inflexible and indiscriminate by applying to all disposals, regardless of the nature of the land, the manner of disposal and the value of the land.
- 7.54 The 1992 Regulations were also criticised for being overly prescriptive (for example by requiring the measurements of individual rooms) but also for “surprising omissions” (for example, insufficient focus on how the value of the land could be enhanced).
- 7.55 Consultees said that the 1992 Regulations were not well known amongst RICS surveyors, but that when non-compliant reports are returned to surveyors their re-draft “very rarely [adds] anything to the substance of the advice”.<sup>488</sup> Sustrans and Railway Paths said “I have sometimes had to decide whether to return a perfectly satisfactory report, and risk delaying the transaction, simply because it was not in the format specified by the 1992 Regulations despite this format being unsuitable for the transaction in question”.

### (5) The stage at which advice is obtained

- 7.56 In the Consultation Paper, we said that, strictly speaking, Part 7 requires charities to obtain advice on marketing, and then advice on the terms of the proposed disposition. We said that the CLA had reported that “trustees often adopt the more pragmatic approach of instructing surveyors only at the later stage”. Some consultees thought advice at two stages was unnecessary, and agreed that in practice a report is often only obtained during the conveyancing process.

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<sup>487</sup> Charities Act 2011, s 124(8).

<sup>488</sup> Val James (solicitor).

## (6) The nature of advice on value

### 7.57 Sustrans and Railway Paths said that a valuation was unnecessary:

The current requirements misunderstand the purpose and nature of a valuation. A formal valuation is usually only required when the valuation figure has to be relied on without being tested in the market – for example, for reporting on a company's asset values, or for taxation purposes. In my 30 years' experience in the private sector it was unusual to obtain a formal valuation for an open market sale or letting which had been properly exposed to the market, although advice would be taken on the appropriate price or rental level to expect.

By insisting on formal valuation reports in all situations the charitable sector is often being asked to pay for a higher level of professional advice than is really necessary. What is actually required is a marketing report, which costs less than a formal valuation, and will often be included in the fee for achieving the disposition at no extra cost.

## (7) Inconsistencies

### 7.58 In the Consultation Paper, we highlighted two inconsistencies that arise as a result of the Part 7 regime.

- (1) *Acquisition and disposal.* The Part 7 regime does not apply to the acquisition of land.<sup>489</sup> Consultees commented that the risk to charity funds is similar when charities are acquiring land and disposing of land; just as they may sell land at an undervalue, they may pay too much when purchasing land. As a result, the Charity Commission “strongly recommends” that trustees follow the Part 7 procedure when acquiring land to ensure compliance with their duties.<sup>490</sup>
- (2) *Different types of asset.* Part 7 imposes detailed requirements on the disposal of charity land, but there is no equivalent regime for the disposal of other charity assets, such as shares, artwork, jewellery, or intellectual property.<sup>491</sup> Nor is there a regime regulating purely contractual arrangements that do not involve land; if the charity enters into a contract and then defaults on its obligations, the outcome could well be an award of damages enforced by a charging order over charity land.

## (8) Legacy cases

### 7.59 The Institute of Legacy Management, Cancer Research UK and the National Trust explained the difficulties that arise under Part 7 in the disposal of land left to a charity by will. Initial confusion stems from the fact that such land is usually sold by the personal

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<sup>489</sup> Save that Part 7 imposes formality requirements when charities acquire land. Where trustees are acquiring land as an investment, they will be required to comply with the investment duties under the Trustee Act 2000, most notably the requirement to obtain advice unless they reasonably consider it unnecessary to do so. We discuss the investment duties in more detail in *Social Investment by Charities (2014) Law Commission Consultation Paper No 216*, para 3.68 and following.

<sup>490</sup> Charity Commission, *Acquiring Land* (CC33) (April 2001), para 18, available at <https://www.gov.uk/government/publications/acquiring-land-cc33>.

<sup>491</sup> Save that assets which are held as an investment are subject to the investment duties under the Trustee Act 2000.



representatives, without the charity becoming the legal owner,<sup>492</sup> so the charity's interest is not recorded on the register of title by a restriction and the purchaser (and often the personal representatives) are unaware of the need to comply with Part 7.

7.60 But even when the parties are aware of Part 7, the application of the regime in different cases is uncertain and inconsistent. When land forms part of the residue of an estate and the residue has been left to a charity, it can be sold by the personal representatives without having to comply with Part 7. By contrast, if the land has been "appropriated" to a charity by the personal representatives<sup>493</sup> the land will be "held by or in trust for a charity" within the meaning of section 117(1) of the 2011 Act. Part 7 will therefore apply to any disposal and the charity trustees must comply with the regime.<sup>494</sup> Similarly, some consultees suggested that property that has been specifically devised to a charity in a will falls within the regime. The property will be sold by the personal representatives (as legal owners) but the charity trustees must provide the certificate of compliance with the Part 7 requirements.

7.61 There can be a "deemed appropriation" of property once the residue of the estate is ascertained.<sup>495</sup> Cancer Research UK said that "a sale of the property after this point may take place without any steps being taken by the [personal representatives] to comply with [Part 7], but this is something which we are not able to control. Indeed, we may not be advised of a sale until long after it has completed" so charities are "in a position of non-compliance without them even being aware of it until much later in the administration".

7.62 Further confusion arises if the land has been specifically devised to, or appropriated to, more than one charity. The problem of land held by or in trust for multiple charities applies more widely than the legacy context and is therefore addressed separately below.

#### (9) Multiple beneficiary cases

7.63 There is some confusion regarding the application of Part 7 in cases where land is held by or in trust for multiple charities. This issue arises primarily in the legacy context but is not confined to such cases. There are three potential problems.

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<sup>492</sup> This will depend on whether, in the administration of the estate, the executors (a) transfer the property to the charity (in which case the charity will become the legal owner) or (b) sell the property and transfer the proceeds of sale to the charity (in which case the charity never becomes the legal owner). The norm is for executors to do the latter.

<sup>493</sup> Appropriation is "the process whereby a representative uses a specific asset to meet in full or in part the pecuniary entitlement of a beneficiary": *Williams, Mortimer & Sunnucks on Executors, Administrators and Probate* (20th ed, 2013) para 55-54. When property is appropriated to a beneficiary, the beneficiary acquires the beneficial interest in the property. Property is often appropriated to a charity in the course of the administration of an estate for tax reasons, and very often the appropriation will only occur after the personal representatives have marketed the property and accepted an offer from a purchaser.

<sup>494</sup> S Roberts and E Millington, "Disposals of Land by Charities" (2006) 9 *Charity Law and Practice Review* 1, 2, n 8; T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 121 to 122.

<sup>495</sup> *IRC v Smith* [1930] 1 KB 713, 733, by Lord Hanworth MR; HMRC, *Capital Gains Manual* (March 2016), CG30900P, CG30940; A Talbot, "Disposing of assets on behalf of charities" (2007) *Private Client Business* 60.

- (1) A surveyor providing advice under Part 7 is required to be acting “exclusively for the charity”. This arguably requires, in a case where land is held by or for multiple charities, each charity to obtain separate advice from a surveyor.<sup>496</sup>
- (2) Charity trustees must be satisfied, having obtained and considered a surveyor’s report, that the proposed terms are the best that can reasonably be obtained for the charity. There might be a conflict in the case of multiple charities, whereby the best terms for one charity are not the best terms for another.
- (3) The decision to make a disposal of the land lies with the trustee(s) of the land, not the multiple charities as beneficiaries under that trust. It is odd to require those charities to comply with Part 7 when they are not controlling the disposition.

7.64 In the legacy context, it has been suggested that in such a case the Part 7 requirements fall not on the charity trustees of the individual charities, but instead on the personal representatives.<sup>497</sup> And when property is held on trust for a charity (or charities) and another non-charitable beneficiary, it would appear that Part 7 is not engaged.<sup>498</sup> However, it is not clear what the true legal position is.

#### (10) Compliance in practice

7.65 In the Consultation Paper, we reported that the Institute of Legacy Management had suggested that legal advice on Part 7 is inconsistent, that many charities are unaware of Part 7 and that Part 7 is sometimes ignored because it is too complicated.<sup>499</sup> It has been suggested that there is confusion as to when it applies and that Part 7 is “often honoured in the breach”.<sup>500</sup> In addition, there can be uncertainty as to whether land falls within the definition of charity land such that the Part 7 limitations apply.<sup>501</sup>

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<sup>496</sup> There are differing views as to whether one surveyor can act for all charities in this situation: see the Institute of Legacy Management Approved Factsheet on Section 117 Charities Act 2011 (August 2012), available at <http://legacymanagement.org.uk/wp-content/uploads/Section-117-Charities-Act-2011.pdf>, and the CLA’s evidence to the Joint Committee on the Draft Charities Bill (July 2004), available at <http://www.publications.parliament.uk/pa/jt200304/jtselect/jtchar/167/4061624.htm>, para 139.

<sup>497</sup> This is the Charity Commission’s view: S Roberts and E Millington, “Disposals of Land by Charities” (2006) 9 *Charity Law and Practice Review* 1, 2, n 8. Dumont and Wilson have argued the contrary, but acknowledge that the Charity Commission’s approach is more practical: T Dumont and F Wilson, “When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors” [2004] *Private Client Business* 118, 122 to 124. Dumont and Wilson argue that “the practical problems which flow from these statutory requirements need urgent clarification so as to ensure that they serve the purpose for which they were originally intended”; above, at 125. The CLA raised a similar concern in its evidence to the Joint Committee on the Draft Charities Bill (July 2004) paras 135 to 137. See also J Warburton, “Restrictions on Dispositions of Charity Property – Protection or Undue Burden?” in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 p 131.

<sup>498</sup> This was Cancer Research UK’s interpretation. The question turns on whether the words “held by or in trust for a charity” mean land held on trust *solely* for a charity, or land held on trust *in whole or in part* for a charity.

<sup>499</sup> Institute of Legacy Management submission to Lord Hodgson’s review.

<sup>500</sup> J Smith, “Disposals of property and Section 36” (November 2010), available at <http://www.farrer.co.uk/Global/Briefings/09.%20Higher%20Education/Disposals%20of%20property%20and%20Section%2036.pdf>.

<sup>501</sup> For example, in *Maidment and Ryan v Charity Commission for England and Wales* [2009] UKFTT 377 (GRC), both the solicitors acting for the vendor and the solicitors acting for the purchaser had concluded – incorrectly – that the land was not held on a charitable trust, and that the statutory limitations did not apply.

## (11) Uncertainties

7.66 Consultees<sup>502</sup> criticised various other points of detail in Part 7, saying that they led to uncertainties in the law.

- (1) There is often an assumption that it requires “best price” rather than “best terms”.
- (2) There can be confusion over whether a party is a “connected person”, for example, as to the status of a wholly-owned subsidiary.
- (3) There is uncertainty as to the meaning of “disposition”, which is undefined.
- (4) It is unclear whether rentcharges fall within the disposal or mortgages regime.
- (5) There are doubts as to whether certain duties can be delegated by trustees, for example obtaining and considering reports and giving a certificate of compliance with Part 7.

### Support for the Part 7 regime

7.67 By contrast, some consultees strongly supported the Part 7 regime. Bates Wells Braithwaite argued that there would be a “significant risk for charity trustees, and cost to the third sector as a whole, if these provisions are removed”. Consultees’ comments fell into three broad categories.

#### (1) Protecting charitable assets

7.68 The regime protects charities from imprudent (or even reckless or dishonest) decisions of trustees by ensuring that charities obtain the best terms when they dispose of land (and that they can afford the obligations undertaken in mortgages). Consultees said that charity trustees are often insufficiently experienced to deal with property transactions, which can be complex. They might not realise that a small strip of land has ransom value, that the grant of an easement might diminish the value of the land by thwarting future development, that division and sale in parts might be preferable, or that the value of the land could be enhanced by improvements to the land or a change of planning use. The National Trust added that property transactions are often fast-paced and exciting, with a risk that objectivity is lost; Part 7 ensures that “hearts have been ruled by heads”.

7.69 Consultees gave various examples of cases where advice from a RICS surveyor prevented a charity from selling land at below market value. A fellow of the Central Association of Agricultural Valuers (“CAAV”) gave the following example. A charity held a lease of land at a nominal rent, but the land was surplus to its requirements and was seen as a liability since it was disused, overgrown and insecure. The landlord wanted the land back for redevelopment. “The trustees had reached a careful and duly considered position and the disposal appeared eminently sensible in their minds, but in my view they were not aware of the strength of their position”. The surveyor’s involvement secured the charity a better deal.

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<sup>502</sup> In particular the CLA and Bircham Dyson Bell LLP.

7.70 Consultees were also concerned about potential exploitation of charities, particularly small charities. Cluttons LLP said that many buyers see charities as “a soft touch” and “the rigour of the current regime is a very powerful negotiating tool to rebut such views and to obtain best value”. Professor Gareth Morgan (Sheffield Hallam University) said that it was “important to protect smaller charities with limited expertise from being hoodwinked by a developer”.

7.71 Some consultees supported the 1992 Regulations; they cover “the basics” that should be considered in every case.<sup>503</sup> Gerald Eve LLP disagreed with our statement in the Consultation Paper that “the matters to be considered when disposing of a one-bedroom flat will be different from those to be considered when disposing of a 100-acre field with development potential”. They said that, no matter the type of property, the 1992 Regulations ensure that all matters have been investigated and considered in calculating the value of the land.

## (2) Stage at which advice is obtained

7.72 Gerald Eve LLP said that it was important to obtain advice on marketing and then advice on value and gave examples of cases where charities had approached them late in the day with a proposed transaction that would not have achieved full value for the charity. They said that the “more pragmatic” approach described by the CLA of obtaining advice on the terms of a proposed disposition (see paragraph 7.56 above) was “fundamentally flawed”.

## (3) Framework for decision-making

7.73 The regime provides a helpful framework for trustees, particularly when they are inexperienced or cautious about entering into high-value transactions. A statutory structure for the decision-making process can reassure trustees that they are unlikely to be found to have breached their duties.

7.74 By contrast, Bircham Dyson Bell LLP said that compliance with Part 7 “does not necessarily equate with compliance with the charity trustees’ duties. The current regime may, therefore, give rise to false confidence”. Stone King LLP, whilst cautious about deregulation, said that they always advised charities that “the ‘techie’ regulation is just a reminder mechanic – to check and validate all is well – as all fiduciary duties should already have meant the trustees have done the key thinking so as to do the right thing”.

## Conclusion

7.75 The Part 7 regime is loved by some and loathed by others. Stone King LLP summarised the position neatly; there are “numerous examples both of very significant help from the current regime plus examples of its clumsiness and disproportionality”. Part 7 undoubtedly saves charities from bad bargains in some cases, but does that justify a universal top-quality advice requirement?

## OUR PROPOSALS FOR REFORM OF THE ADVICE REQUIREMENT

7.76 In the Consultation Paper, we said that it was necessary to strike a sensible balance between protecting charities’ assets and avoiding unnecessary expense and bureaucracy. We suggested that a better approach to the regulation of disposals of

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<sup>503</sup> Cluttons LLP.

charity land (including mortgages) might be to require trustees to obtain advice, but to leave to them the decision as to what advice would be appropriate for a particular transaction. This would give the trustees the flexibility to decide:

- (1) at what stage the advice is required (advice on a marketing strategy, advice on the proposed sale price, or both);
- (2) the level of detail that is required (it may be a detailed formal report, or it may be oral advice); and
- (3) who should give the advice (it may be a qualified surveyor, an estate agent, or another professional).

7.77 We also suggested that trustees should be given the power to dispense with the requirement to obtain advice if they reasonably considered that it was unnecessary to do so.<sup>504</sup>

7.78 We therefore provisionally proposed that:

- (1) the default prohibition<sup>505</sup> on the disposal of charity land should be removed;
- (2) in its place should be a duty on trustees, before disposing of charity land, to obtain and consider advice in respect of the disposition from a person who they reasonably believe has the ability and experience to provide them with advice in respect of the disposal; but
- (3) the duty to obtain advice should not apply if the trustees reasonably believe that it is unnecessary to do so.<sup>506</sup>

7.79 We said that this flexible requirement to obtain advice would go a long way to ensuring that charities' assets are protected from disposal at an undervalue, but acknowledged that the protection would perhaps not be as extensive as that under the current regime. We said that it would avoid the straightjacket, and unnecessary costs, of the current regime, and recognise that the law should defer to trustees' good judgement. We said that trustees would continue to be reassured by the provision of advice, and that that reassurance would be further bolstered by guidance from the Charity Commission, which would be an essential part of ensuring that trustees complied with their duties when disposing of charity land.

7.80 Before summarising consultees' responses to our proposal, and making recommendations for reform, we consider a preliminary point about the current regime that was raised by many consultees.

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<sup>504</sup> Such a power would mirror trustees' duty under the Trustee Act 2000 to obtain advice on investments unless they reasonably consider that it is unnecessary or inappropriate to do so: Trustee Act 2000, s 5(3).

<sup>505</sup> See para 7.15.

<sup>506</sup> Consultation Paper, para 8.85.

## Restrictions on the register

- 7.81 We described the special conveyancing procedures designed to protect purchasers in paragraphs 7.37 to 7.45 above. In the Consultation Paper, we said that whether those conveyancing procedures should change would depend upon whether we went on to recommend the maintenance of a regime under which non-compliance renders a transaction void. We had proposed a new regime that would not have the effect of rendering the transaction void in the event of non-compliance.<sup>507</sup> We said, therefore, that the special conveyancing rules would become unnecessary.<sup>508</sup>
- 7.82 Many consultees argued strongly in favour of retaining the existing restriction in the register of title, and the certification procedure in Part 7, as a simple, cheap, efficient and effective mechanism to enforce trustees' duties (whatever they may be) in respect of land disposals. Stone King LLP said that land registration permitted a "very helpful protection mechanism"; the restriction on title allows policing of the Part 7 requirements by the buyer, or mortgagee, of land in the conveyancing process. They said that the same protection mechanism is not available in respect of land acquisition, or the disposal or acquisition of other assets, which might explain why the law does not include protective measures for those transactions. Like other consultees, Stone King LLP was keen that the mechanics of restrictions be "used as much as can be to steer the trustees to whatever the duties are so that they are given every chance to do the right thing".
- 7.83 So whilst we had said in the Consultation Paper that the conveyancing procedures should depend on the advice requirements, these consultees approached the question from the opposite direction and said that the advice requirements (with, or without, some modification) should be fitted into the existing conveyancing procedures. In the light of consultation, we see the practical advantage of the restriction in the register, and the Part 7 certificate, and we recommend its retention in any new regime.
- 7.84 A restriction can be entered on the register to prevent "invalidity or unlawfulness" in a transaction.<sup>509</sup> The restriction is currently entered on the register owing to the general prohibition on the disposal of charity land which would, in the event of non-compliance, render the transaction void.<sup>510</sup> It is not necessary to retain the general prohibition in order to retain the restriction and certification regime; if a new regime imposed duties on trustees, non-compliance with which would not render the transaction void (as we proposed), a restriction could still be entered on the register requiring certification by the trustees that they had complied with the duties.<sup>511</sup> Some consultees who favoured retention of the restriction mechanism wanted to remove the general prohibition (and to go further by conferring a general power to dispose of land). Given consultees' satisfaction that the current restriction and certification regime works well as a policing

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<sup>507</sup> Non-compliance would be a matter for the trustees personally because it might be a breach of trust, but it would not impugn the transaction so far as a purchaser is concerned.

<sup>508</sup> Consultation Paper, para 8.36, and 8.105 to 8.106. Although they might be retained in order to safeguard purchasers when the limitation on the trustees' powers arises not from Part 7 of the Charities Act 2011 but from the trust deed or other governing document: see Consultation Paper, paras 8.111 to 8.113.

<sup>509</sup> Land Registration Act 2002, s 42.

<sup>510</sup> See para 7.15.

<sup>511</sup> Such a restriction would prevent "unlawfulness" rather than "invalidity" under the Land Registration Act 2002.

mechanism it is unclear what amending the framework within which it operates – namely the general prohibition on disposing of charity land – would achieve.

### What should the advice requirements be?

The problem: competing considerations

7.85 Part 7 requires charities to obtain advice from a RICS surveyor for most land disposals. Whilst there are some exceptions,<sup>512</sup> it is a fairly blanket requirement. Similarly, the 1992 Regulations set out in detail the matters on which a RICS surveyor must provide advice. The regime is largely a “one size fits all” approach.

7.86 But a regime for land disposals should be suitable for:

- (1) a wide range of charities, including:
  - (a) large charities, such as Cancer Research UK;
  - (b) small charities, such as local village hall charities or small religious orders;
  - (c) charities with no property expertise; and
  - (d) charities with significant property expertise, such as the Landmark Trust or National Trust.
  
- (2) a wide range of land transactions, including:
  - (a) the sale of different types of land such as an office, agricultural land, a brownfield development site, a residential property, and a small strip of land along a boundary.
  - (b) the sale of land that is held for different reasons, such as:
    - (i) land owned by a charity purely as an investment;
    - (ii) land left to charity by will;
    - (iii) land that is used by the charity to pursue its purposes, known as “functional land”;<sup>513</sup> and
    - (iv) land that is surplus to the charity’s requirements.
  - (c) different types of disposals, such as transfer of a freehold, transfer of a long lease, granting a short lease, or granting an easement.
  - (d) the sale of land intentionally at less than market value, or for nominal consideration, in pursuit of the charity’s purposes.

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<sup>512</sup> Principally for short leases, exempt charities, and certain other land disposals: see paras 7.13, 7.14 and 7.23.

<sup>513</sup> See n 412.

- (e) disposal of a valuable asset and disposal of what is, in effect, a liability (such as the assignment, or surrender, of an office lease where the passing rent is above the market rent).
- (f) granting a lease of a residential property to an employee of the charity.

7.87 In devising our recommendations for reform, we have tried to:

- (1) establish the best default rule;
- (2) ascertain whether and how the regime might apply different rules in different cases by adopting categorisations that reflect different levels of risk in a transaction, for which tailored and proportionate rules can be devised (for example, creating categories according to the nature of the transaction, or the size of the charity);
- (3) decide whether the exceptions to the default rule should be the same, reduced or expanded; and
- (4) keep the regime as simple as possible.

7.88 We have also sought to achieve an appropriate balance between the various competing policy aims underpinning the project more widely, namely:

- (1) giving charities flexibility and autonomy in how they are run;
- (2) removing inefficient and unduly complex regulation of charities;
- (3) ensuring adequate protection of charity assets; and
- (4) maintaining public trust and confidence in the charity sector through proper oversight and accountability.

#### Consultees' views

7.89 Consultees expressed a wide range of views on our proposal to make the advice requirement more flexible, from suggesting complete de-regulation through to advocating retention of the existing regime. The majority of consultees thought that the regime should be reformed; less than 15 per cent of consultees wanted to retain the current regime (with or without minor modification).

7.90 The following themes emerged from consultation responses.

#### General duties versus specific duties

7.91 Some consultees thought that the general duties on trustees, or the investment duties on trustees under the Trustee Act 2000, were adequate to guard against the risk of charity land being sold at an undervalue.

#### Land and other assets

7.92 Some consultees saw no reason to treat the disposal of land differently from the acquisition of land, nor any reason to treat land differently from other assets. Conversely, it was suggested that land was a unique asset and should be treated



differently. It has also been suggested to us that there is commonly some familiarity with land but not with other assets such as shares; trustees who (for example) own their homes may have misplaced confidence in their ability to make decisions concerning land whereas they may be more cautious to make the same decisions concerning shares.

- 7.93 Whilst land is a different asset class, we do not think that there is a principled reason why land should always be treated differently from other assets in terms of the advice requirements, since other assets can be equally if not more valuable and complex (for example, intellectual property rights). But we must acknowledge that there is historic protection of land transactions which, consultation has revealed, does prevent charities from selling land at an undervalue in some cases. And as Stone King LLP said, restrictions on the land register of title, and the Part 7 certification procedure, do provide a unique mechanism to enforce trustees' duties when they dispose of land, as well as a helpful steer for trustees towards doing the right thing.

#### Large and small charities

- 7.94 There is a notable difference between large and small charities, and the extent to which they can be trusted to make appropriate decisions and the extent to which they benefit from a framework for decision-making. The charities that responded to our consultation tended to be large charities which have less need for regulation of their land transactions, but as Stone King LLP emphasised it is the smaller charities with less experienced trustees that are likely "to get the real benefit of the protections against accidentally going astray".

#### Choice of adviser and stage at which advice is obtained

- 7.95 Some consultees thought it would be helpful to have flexibility to choose an appropriate adviser, based on the nature of the land and the stage at which advice is obtained. Others said that trustees cannot be expected to choose an appropriate adviser, or the appropriate point at which to obtain advice, when they are not experts in property matters.

#### Deciding not to obtain advice

- 7.96 There were mixed views as to whether trustees should be permitted to decide not to obtain advice. Some thought it would allow trustees to avoid unnecessary and disproportionate costs. Others said they should always obtain advice from someone, even if not a RICS surveyor; "in some cases charity trustees do not know what they do not know; i.e. they need professional advice to understand the value of the land".<sup>514</sup> Some consultees thought it was important that if charities decide not to obtain advice, they should formally record the reasons for their decision.

#### The 1992 Regulations

- 7.97 Some consultees criticised the 1992 Regulations, saying that they should be simplified or repealed; others supported them, saying that they should be retained.

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<sup>514</sup> Anthony Collins Solicitors LLP.

## Response to our proposal

7.98 Those who disagreed with our proposal did so for the following reasons:

- (1) It would result in insufficient protection of charitable assets; advice should only ever be obtained from RICS surveyors who have appropriate expertise, supported by professional indemnity insurance.
- (2) Trustees cannot be expected to know who to approach for advice.
- (3) Trustees, often being risk-averse, would obtain advice anyway; the flexible duty would “turn into a duty always to obtain advice”.<sup>515</sup>
- (4) The benefits of advice go beyond just valuing the land; advice can assist charity trustees to take a broader view about how they can use the charity’s land to achieve the charity’s purposes.

## Importance of guidance

7.99 Many consultees commented on the importance of Charity Commission guidance, particularly for smaller charities and inexperienced trustees. Guidance was said to be important regardless of whether the Part 7 regime is reformed, but particularly if trustees are to be given the flexibility to choose their type of adviser or to choose not to obtain advice. For example, Veale Wasbrough Vizards LLP said that guidance should emphasise the need for advice in the case of the sale of part of land, or the grant of rights over charity land which can have “major consequences for the value of the charity’s land on any future disposal”. Stone King LLP said that, without useful guidance, “trustees will start spending as much on checking with their lawyers as they did on surveyors”.

## Conclusion

7.100 While a clear majority of consultees considered that Part 7 was in need of reform, there was no consensus amongst consultees as to what form the reform should take. The arguments for and against the different options are finely balanced. We started this section by setting out the competing considerations. It is not possible to legislate for all eventualities, and nor is it possible to solve all the potential problems with charity land transactions. Similarly, imposing a universal regime on all land transactions cannot provide an answer that is well suited to every situation. It is for these reasons that the current regime, with its almost universal requirement for a RICS surveyor’s report, has been criticised by consultees; its reach is too wide and its requirements too prescriptive.

7.101 We turn now to consider the various options for reform as well as our recommendations for reform. We have set out in paragraphs 7.87 and 7.88 above what we consider to be the appropriate aims in devising those recommendations.

## Options for reform of the advice requirements

7.102 We think that the following options are available. Some could be adopted in combination.

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<sup>515</sup> Bircham Dyson Bell LLP.

Option (1): no change

7.103 There was a strong, but minority, voice in consultation that favoured retention of the existing regime. In our view, however, the criticisms of the regime set out above justify reform.

Option (2): distinguish between large and small charities

7.104 Many consultees noted the difference between large and small charities. It would be possible to create categories to reflect different levels of risk. Regulation could be tailored to the category of charity. It would be possible to categorise charities into large and small (based on whether the charity's income was above or below, say, £1 million), and extend a more flexible advice requirement to larger charities.

7.105 We think that such categorisation would be a crude approach. The impact of a more onerous advice requirement would be greater (proportionally) on small charities than on large charities. Further, there is no necessary correlation between the size of a charity and the expertise the charity has in respect of property. A small charity may in fact have expertise, while a large charity might not. Furthermore, large charities potentially have more valuable assets to lose with greater reputational consequences than small charities if they do not have suitable expertise.

Option (3): distinguish further between different categories of disposal

7.106 Rather than distinguishing between charities on the basis of their size (the approach in option (2)), a distinction could be drawn based on the type of transaction. The requirements imposed on a charities could then be tailored to reflect the risks involved in particular transactions. The current law is already tailored to particular transactions by imposing different advice requirements for:

- (1) mortgages (see paragraph 7.31 to 7.36);
- (2) leases of up to seven years (see paragraph 7.23); and
- (3) all other disposals (see paragraphs 7.19 to 7.22).

7.107 It would be possible to remove further categories of disposal from (3). Three consultees suggested changing the transactions to which the detailed advice requirements applied.<sup>516</sup> The advice requirements could apply, for example, only in the case of freehold transfers and long leases (thereby excluding the grant of easements and certain leases). Or the sale of residential property could be excluded from the advice requirements.

7.108 We do not favour such an approach. Just because property is residential does not mean that it is easier to value; for example, it might have development value. And the grant of an easement might have a significant effect on the value of the charity's land, for example, by hindering future development.

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<sup>516</sup> Bates Wells Braithwaite; the compromise view of the CLA; and Institute of Legacy Management.

Option (4): a de minimis threshold

7.109 Some consultees thought that transactions below a certain value (suggestions ranged from £5,000 to £50,000) should be excluded from the requirement to obtain advice. Others disagreed; a small strip of apparently insignificant land might have unknown ransom value, or an easement granted for nominal consideration might significantly reduce the value of the land.

7.110 We do not think that a de minimis threshold would work in practice; it depends on charities themselves first valuing the land to establish whether the transaction falls above or below the threshold; in order to do that, they would usually need advice.

Option (5): certification of compliance with trustee duties or with guidance

7.111 Bircham Dyson Bell LLP and some members of the CLA suggested replacing the advice requirements with a certification requirement (similar to the existing Part 7 certificate). Trustees would have to certify that they had power to enter into the transaction and that they had complied with their duties, including their duty to manage conflicts of interests (which would avoid the need for connected persons provisions, on which see further below). The requirement for a certificate would alert trustees and professionals to the existence of trustees' duties, which would be the subject of guidance from the Charity Commission.

7.112 We can see the attraction of this suggestion, but we think that it is too imprecise to require trustees to certify that they have complied with all of their duties, whatever they may be. We expect that trustees would always say that they have complied with their duties, and we are not convinced that the certification requirement would drive them to obtain advice in appropriate cases.

7.113 As well as being imprecise, we fear that it might concern trustees when they dispose of land. They might ask: what is so special about land transactions that we must certify that we have complied with our duties? And there might be an implication that their duties are therefore different, or more specific, than in other contexts when, in reality, they would not be since this suggestion for reform relies on general trustee duties, and on Charity Commission guidance.

7.114 In a similar vein, Withers LLP suggested replacing the advice requirements with a statutory obligation to consider Charity Commission guidance on the disposal of land. The trustees would be required to provide a certificate confirming that they had complied with the requirement to have regard to the guidance. The guidance would cover the fundamental issues such as disposals to connected persons, obtaining the best terms, and taking account of the charity's objects.

7.115 We think that this approach would be novel, and potentially unpopular, particularly in the light of other consultees' concerns about Charity Commission guidance becoming "de facto law" or being given an elevated status. The Commission's guidance might be unclear or contain inaccuracies, and in those circumstances it would be unfortunate if statute compelled trustees to have regard to it.

7.116 In addition, we think that it would be onerous to require trustees to consider Charity Commission guidance each time they dispose of charity land. If a transaction is straightforward and trustees are happy to obtain professional advice, they should not

invariably be required to read guidance about the complexities and nuances of different types of land transaction and the circumstances in which professional advice should be obtained (though, of course, it would usually be prudent to do so).

Option (6): a flexible duty to obtain advice

7.117 As we proposed in the Consultation Paper, it would be possible to replace the requirement to obtain a RICS surveyor's report with a more flexible requirement that trustees obtain advice from someone they reasonably believe can provide them with advice. The flexible requirement would operate either with, or without, a power for the trustees to decide not to obtain advice, if they reasonably believe that it is unnecessary to do so.

7.118 We note consultees' concerns about the requirement to obtain advice being too vague; it might be difficult to expect trustees to work out who is the most appropriate professional to provide advice, and at what stage advice should be obtained, when trustees themselves are not experts. We also see the advantage of charities obtaining advice from a property professional, and the advantage of Part 7 explicitly requiring that. Val James said that the default position should be that advice will be obtained from someone professionally qualified in land valuation. We agree.

7.119 That led us to consider a more nuanced approach which would still give charities some flexibility in deciding whether, when and from whom to obtain advice, but retaining the starting point that advice should generally be obtained from a property professional unless the trustees have a reason to do otherwise.

Option (7): permitting charities to dispense with the requirement to obtain advice if they decide that it is unnecessary to do so

7.120 It would be possible to retain the default requirement that trustees obtain advice from a property professional ("a designated adviser") but to give charities the ability to decide whether or not it is necessary or appropriate to obtain advice. We considered adding a new procedure to Part 7 allowing trustees to decide that the requirement to obtain advice from a designated adviser should not apply to a proposed transaction (a "dispensation power").

7.121 The proposed dispensation power led to diametrically opposing views from stakeholders (both in consultation responses and at a subsequent meeting with members of the CLA and Charities' Property Association). In an attempt to reach a compromise we tried to add various qualifications to the power to try to make it more acceptable to those opposing it. For example, we considered including a requirement that trustees have regard to Charity Commission guidance in deciding whether or not to use the dispensing power; the guidance could explain the circumstances in which the procedure might be used and the relevant considerations to be borne in mind when deciding not to obtain advice from a designated adviser. Trustees would need to be satisfied that, having regard to the Charity Commission's guidance, it is unnecessary or inappropriate to obtain advice from a designated adviser. We also considered a prohibition on blanket decisions to dispense with advice, forcing each transaction to be considered on its facts.

7.122 In deciding not to recommend a dispensation power, we were driven by the following concerns.

- (1) Risk-averse trustees would always obtain advice before invoking the dispensation power because the proposed condition for dispensation – that advice is “unnecessary or inappropriate” – is arguably very vague. If that is the case, trustees will not save time or costs, because they will simply be paying lawyers rather than surveyors. Conversely, reckless trustees could invoke the dispensation power too readily in order to avoid obtaining advice in circumstances when they ought to do so.
- (2) Some consultees who supported relaxing the current advice requirements may have an unrepresentative view of trustee attitudes. For example, solicitors are more likely to be exposed to risk-averse charity trustees who have chosen to seek legal advice than more reckless ones who are less likely to do so.
- (3) There are several examples of cases in which the requirement for charities to obtain advice has avoided bad bargains. We have also explained that some trustees, given the opportunity, might proceed with land transactions without advice just because they think that they understand property and its value.
- (4) We were cautious about relying too heavily on Charity Commission guidance to support a dispensation power. For statute to require trustees to have regard to such guidance means that the guidance effectively has statutory effect. The Charities Act 2006 required the Charity Commission to produce statutory guidance concerning public benefit, which was the subject of much controversy and litigation. Rather than setting out requirements which trustees are required to consider in guidance, we think it might be clearer (and more welcome in the sector) if we simply set out the requirements in legislation.
- (5) Finally, the current regime is, in practice, self-regulatory, with trustees being required to obtain advice from a RICS surveyor to ensure that they comply with their duty to obtain the best terms for the charity. Introducing a dispensation power might increase the burden of regulation for the Charity Commission; it would fall to the Commission to investigate and decide whether trustees have breached their duties in deciding to dispense with the advice requirements. Since that option is not currently available to trustees, it is not something that the Commission has to regulate. The Commission already faces significant resource constraints and we are reluctant to impose further strain on its resources unnecessarily.

7.123 In conclusion, given these concerns and the particularly controversial nature of the proposal, we have decided not to recommend that trustees be given a power to dispense with the Part 7 advice requirements. We do not think that a dispensation power would satisfy either those in favour of the existing Part 7 regime nor those seeking to abolish it. We have instead opted for alternative reforms to the current Part 7 regime to alleviate many of the concerns raised by consultees.

Option (8): change the contents and timing of written advice, and the requirement to follow it  
*The 1992 Regulations*

7.124 Consultees' comments on the 1992 Regulations, which set out in detail the matters that must be addressed in a RICS surveyor's report, have been set out in paragraphs 7.54 and 7.55 above. We agree that the 1992 Regulations should be simplified. We agree with the comments of Sustrans and Railway Paths set out in paragraph 7.57; the purpose of the Part 7 advice requirements is to ensure that charities receive advice on marketing land so as to maximise the chances of obtaining the best offer. Designated advisers should be left to decide the matters that are relevant and how best to provide that advice, in reliance on their professional qualifications, standards and experience.

7.125 We therefore think that the 1992 Regulations should be replaced with three principal requirements, namely that the designated adviser should provide:

- (1) advice on what sum to expect (or, if an offer has already been made, whether the offer represents the market value of the land);
- (2) advice on whether (and, if so, how) the value of the land could be enhanced; and
- (3) advice on marketing the land (or, if an offer has already been made, any further marketing that would be desirable).

7.126 These are the key issues on which the trustees should be given advice, without setting out unnecessary levels of detail as to what should be addressed in a report. Our proposed simplification would remove any (actual or perceived) need for a formal valuation of the property, if it has been exposed to the market and the trustees have received advice on what sum to expect.

7.127 We recommend a further requirement. Val James said that "professionals are more aware of the limits of their competency than those instructing them can be". We agree. We recommend below an expansion of the category of designated advisers under Part 7. We think that that expansion will be controlled by a requirement that advisers provide a self-certification that they have the appropriate expertise and experience to provide the advice that is required.

7.128 Our recommendation would require an additional matter to be covered in the written report but it would reflect existing good practice by RICS surveyors; they are expected to decline work which is outside their expertise. The certification requirement would potentially create liability for advisers who wrongly self-certify their expertise and cause financial loss to the charity. This liability would be determined by reference to the professional standards imposed on designated advisers by their regulatory body, with an expectation that it would be backed up by their professional indemnity insurance. Advisers who wrongly self-certify could also be subject to disciplinary sanctions by their professional regulator.

7.129 In addition, we think that the self-certification should also include confirmation that the designated adviser does not have any interest that conflicts with that of the charity. That would ensure, for example, that the adviser is independent of any prospective purchaser of the land in question. Consultees raised concerns about the possibility of charities obtaining and relying on advice from employees or officers of (for example) a property

developer. The designated adviser should be acting to protect the charity's interests and any conflict with those interests should preclude the adviser from acting.

7.130 We think that the advice requirements should continue to appear in secondary legislation to allow easier amendment in the future, should that be necessary. We therefore make a recommendation that the 1992 Regulations be replaced by new regulations setting out simplified advice requirements, together with the new self-certification requirement.

#### *Timing of advice and following that advice*

7.131 We explained above consultees' concerns about a lack of clarity, and lack of pragmatism, concerning the point at which advice should be obtained. We recommend that the requirement that trustees must advertise the proposed disposition as advised in the surveyor's report<sup>517</sup> be removed. This requirement is overly prescriptive and unnecessary. Part 7 requires trustees to be satisfied, *having considered the report*, that the transaction achieves the "best terms".<sup>518</sup> If the report has recommended advertising (something which the replacement 1992 Regulations will require advisers to address) and the trustees have disregarded this advice, they ought not to be satisfied that they have complied with Part 7. Nor, however, should trustees be compelled by statute to advertise exactly as the adviser recommends, which is what the Act currently requires. In combination with our recommendation to simplify the 1992 Regulations, this recommendation will also address concerns that, under the current regime, trustees who obtain advice early are required to obtain duplicate advice at a later stage.

#### *The result*

7.132 Our recommendation to simplify the 1992 Regulation, and to remove the apparent requirement to obtain advice before and after marketing land, would make the Part 7 regime simpler, more coherent and less burdensome for charities. Ideally, trustees would obtain advice early, and they would not be required obtain subsequent advice as to whether an offer represents the market value of the land (though they might choose to do so). But in some cases advice might continue to be sought at a late stage after an offer had been obtained, in which case advice under the simplified 1992 Regulations will cover any further enhancement or marketing that would be desirable and advice as to whether the offer represents the market value of the land.

#### Option (9): expanding the category of approved advisers

7.133 Part 7 designates those property professionals who are qualified to give advice to trustees, and is currently limited to RICS surveyors. Some consultees wanted to retain the requirement to obtain advice, but expand the category of people permitted to provide advice. There were suggestions that estate agents and fellows of the CAAV should be permitted to provide advice. Some consultees also wanted it to be made clear that in-house expertise (staff or trustees) could be used, subject to managing conflicts of interest.<sup>519</sup>

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<sup>517</sup> Charities Act, s 119(1)(b).

<sup>518</sup> Charities Act, s 119(1)(c).

<sup>519</sup> See para 7.52 above.



7.134 In March 2010 the Government consulted on extending the definition of “qualified surveyor” under the Part 7 regime to include fellows of the National Association of Estate Agents (“NAEA”).<sup>520</sup> The consultation gave rise to mixed responses, and raised wider concerns about the statutory framework. The Government concluded that fellows of the NAEA should be included,<sup>521</sup> and stated that it was willing to consider further extension of the definition to include, for example, fellows of the CAAV.<sup>522</sup> However, it decided that the wider statutory framework should first be considered as part of the Hodgson Report, and it has subsequently formed part of our project.

7.135 We agree with Government that there should be more scope for other property professionals to provide advice. In expanding the definition of a “qualified surveyor” in Part 7 we think that there are three key considerations:

- (1) the adviser should have appropriate qualifications and experience to be able to provide advice on enhancing the value of land, marketing land, and the valuation of land;
- (2) the adviser should be regulated by a professional body, requiring advisers to follow professional standards including not acting where there is a conflict of interests; and
- (3) the adviser should hold appropriate professional indemnity insurance.

7.136 We agree with the result of the Government’s consultation that fellows of the NAEA ought to fall into the default category of appropriate advisers on land transactions. All members of the NAEA are regulated by Propertymark (formerly National Federation of Property Professionals) which requires them to maintain professional indemnity insurance, they must not engage in unprofessional or unfair practice, and they are required to have industry-based experience as well as a particular level of qualification.<sup>523</sup> There are several categories of member of the NAEA, the highest of which is a fellow. To become a fellow an individual must pass the level four examination (equivalent to a foundation degree) and have had five years’ experience. Following discussions with the NAEA we think that the expanded list of designated advisers ought to include fellows (but not other categories of member) of the NAEA.

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<sup>520</sup> Cabinet Office, *Making it easier for charities to sell and make other disposals of land: Consultation on extending the definition of ‘qualified surveyor’ in section 36(4) of the Charities Act 1993* (March 2010), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/79216/charity\\_disposal\\_consultation-document.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79216/charity_disposal_consultation-document.pdf).

<sup>521</sup> Cabinet Office, *Making it easier for charities to sell and make other disposals of land: Consultation on extending the definition of ‘qualified surveyor’ in section 36(4) of the Charities Act 1993: Government Response* (March 2010) (“2010 Response”) p 8, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/79219/charity-disposal-land-response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79219/charity-disposal-land-response.pdf).

<sup>522</sup> 2010 Response, p 11.

<sup>523</sup> Propertymark, *Conduct and Membership Rules* (July 2017), available at <http://www.propertymark.co.uk/media/1045366/conduct-and-membership-rules.pdf>. See cl 4 (indemnity insurance), cl 12.1.2 (which prohibits any act involving “unprofessional practice or practice that is unfair to members of the public”), and cl 21 (experience and qualifications).

- 7.137 Similarly, we think that fellows of the CAAV should be designated advisers (many, but not all, of whom are also RICS members in any event). Fellows of the CAAV are property professionals specialising in rural and agricultural land. They must pass an entrance examination, are regulated by the CAAV and must comply with professional conduct standards, including a requirement to maintain indemnity insurance and to manage conflicts of interest.<sup>524</sup>
- 7.138 We also think that the power to add to the list of authorised advisers by statutory instrument should remain.<sup>525</sup>
- 7.139 We acknowledge that a fellow of the CAAV, being an expert in rural and agricultural land, might not be the right person to advise on the disposal of an office block in a large city. And a residential estate agent might not be well suited to advise on the sale of agricultural land. But not every member of RICS would be suitable to carry out such valuations either. There is already a requirement in Part 7 that the trustees must reasonably believe the RICS surveyor “to have ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question”.<sup>526</sup> The same requirement should apply if the trustees decide to instruct an NAEA or CAAV fellow. Moreover, the self-certification requirement that we recommend above (paragraph 7.127) will go a long way to ensure that advice is obtained from a suitable professional.
- 7.140 It seems that Part 7 already allows charities to use trustees and staff as designated advisers, subject to potential obstacles that go beyond the scope of this project (such as complying with professional indemnity insurance obligations and managing conflicts of interest in accordance with professional standards). Indeed, we have heard in consultation that staff (but rarely trustees) already provide advice. Nevertheless, some consultees said that the current position is unclear, particularly as the Act expressly permits such advice in the case of mortgages, but does not make equivalent provision for other disposals. We are recommending that a new provision be inserted into the Act providing that Part 7 advice can be provided by officers and employees of a charity.
- 7.141 It is noteworthy that this reform only means that officers and employees are permitted to provide advice. It does not always mean that it will necessarily be appropriate for them to do so. As already noted, conflicts would have to be managed. In addition, when deciding whether to take advice from a trustee or employee, the charity trustees and the adviser must be clear about potential liability if it transpires that the advice was negligent and caused a financial loss to the charity. A trustee would be providing advice in his or her capacity as a RICS surveyor (or other designated adviser) and should expect to be liable for negligent advice, which may involve a call on the adviser’s firm’s professional indemnity insurance. A RICS surveyor (or other designated adviser) who is an employee of a charity, by contrast, might not be personally liable to his or her employer for negligent advice, and the employer charity might not be insured against

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<sup>524</sup> CAAV Bylaws (January 2016), reg 5.

<sup>525</sup> Charities Act 2011, s 119(3)(a).

<sup>526</sup> Charities Act 2011, s 119(3)(b).

losses caused by the acts of an employee.<sup>527</sup> The position concerning potential liability should be agreed between the charity and employee at the outset and, if appropriate, insurance arrangements can be made. These considerations should be explained in the Charity Commission's guidance on selecting designated advisers.

7.142 It is arguable that the potential lack of recourse in the case of advice from an employee is a good reason for excluding employees from the potential pool of designated advisers. Ultimately, the purpose of Part 7 is to ensure that charities obtain accurate and relevant advice; it is not to provide charities with an insurance policy against inappropriate disposals by relying on a designated adviser's professional indemnity insurance. We do not therefore think that employees should be prevented from acting as designated advisers, simply because the charity might not be able to recover potential financial losses if the advice is negligent. But the existence of that potential recourse, in the event that advice is negligent, is an important consideration for the charity when selecting a designated adviser.

Option (10): applying for dispensation from the advice requirements

7.143 Some consultees thought that charities who found the Part 7 requirements burdensome should seek dispensation from the requirement to comply from the Charity Commission. It is already possible to obtain such dispensation, although very few consultees reported having done so. There appears to be a reluctance on the part of charities to seek authorisation from the Charity Commission, and similarly a reluctance on the part of the Commission to grant authorisation if other options are available.

7.144 We think that the ability to obtain dispensation from the Part 7 advice requirements should continue, particularly since we are not recommending that trustees be given a dispensation power. If a charity experiences a recurring fact pattern that is somehow inconsistent with the regime, then it will be able to apply to the Charity Commission in order to obtain dispensation from the requirements. We would encourage charities who find themselves in this position, particularly those who believe that they have the requisite expertise to manage these transactions in the best interests of the charity without formally complying with Part 7, to apply for dispensation from the Charity Commission.

## Discussion

7.145 As we have indicated, in our view, reform should combine Options (8) and (9). We think that the matters on which designated advisers are required to provide advice should be simplified and rationalised (Option (8)). And the range of advisers who are authorised to provide advice under Part 7 should not be limited to RICS surveyors (Option (9)). We also think that charities should make use of the current route to seek dispensation from the advice requirements from the Charity Commission in appropriate cases (Option (10)).

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<sup>527</sup> For example a RICS surveyor employed in-house is not required to hold professional indemnity insurance: see RICS, *Rules of Conduct for Members* (4 June 2007 version 6), which does not mention indemnity insurance; compare RICS, *Rules of Conduct for Firms* (4 June 2007 version 6), para 9 of which requires firms to hold indemnity insurance. "Firms" for these purposes includes "an unincorporated practice of a sole practitioner concerned with the business of surveying or providing other related services". That definition would not include a RICS surveyor who was employed in-house by a charity. Both rules of conduct are available on the RICS website; <https://www.rics.org/uk/regulation1/rules-of-conduct1/>. See generally RICS, *Chartered surveyors in employment: guidance on liabilities for employed members* (February 2011), available at [http://ricsdev2.uksouth.cloudapp.azure.com/Global/chartered\\_surveyors\\_in\\_employment\\_2016\\_070916\\_TP.pdf](http://ricsdev2.uksouth.cloudapp.azure.com/Global/chartered_surveyors_in_employment_2016_070916_TP.pdf).

7.146 Under our recommended reforms, there will remain a default requirement that trustees must obtain advice from a property professional. Charitable assets will therefore continue to be protected from potential sale at an undervalue. Trustees will have a greater range of potential advisers to choose from than at present, but they will still be directed to three particular categories of property professionals. Charities will have the additional flexibility of being able to choose an adviser (within the designated list) that is best suited to the disposition in question. Our recommendations therefore recognise that different transactions deserve tailored treatment.

7.147 Our recommendation departs from our provisional proposal in the Consultation Paper that trustees should be able to decide whether they obtain advice, but follows the policy of giving trustees greater flexibility in deciding from whom to obtain that advice. This change of policy is a response to consultees' concerns regarding the potential risks when charity trustees dispose of land without seeking appropriate advice. Our recommendations also retain the restriction in the register of title as a mechanism to enforce the trustees' duties.

### **Mortgages and leases of up to seven years**

7.148 As explained above, the advice requirements for mortgages and for leases of up to seven years are different from those for other disposals.

7.149 In the Consultation Paper, we said that the advice requirement for mortgages, to some extent, relates to the internal workings of the charity. Whilst section 124 anticipates advice from just one person,<sup>528</sup> it is arguable that different people are best placed to advise on the three matters identified in paragraph 7.33 above.

- (1) Someone who can advise the trustees on how to achieve the charity's purposes to provide advice on whether the loan or grant is necessary to pursue the particular course of action for which the loan or grant is sought.
- (2) Someone who understands the lending market to provide advice on whether the terms of the loan or grant are reasonable having regard to the status of the charity as its prospective recipient.
- (3) The charity's accountant or the charity's fundraising and finance staff to provide advice on the ability of the charity to repay the loan or grant.

We said that (1) is arguably something the charity trustees themselves are best placed to consider.

7.150 We said that whilst section 124 provides a helpful summary of the matters on which trustees should consider obtaining advice, it may impose an unnecessary straightjacket on trustees. We suggested that the better course would be to leave to trustees the decision as to what type of advice to obtain in relation to a proposed mortgage, with more detailed assistance from Charity Commission guidance, similarly to our proposals concerning disposals. Accordingly we proposed that the new flexible advice requirement should apply to mortgages.

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<sup>528</sup> Charities Act 2011, s 124(8).

7.151 However, following our departure from our provisional proposal for a new flexible advice requirement for dispositions other than short leases, we are not recommending any change to the current advice requirements for mortgages and leases up to seven years. Our recommendations will therefore retain a different regime for leases under seven years, mortgages and other dispositions, with more prescriptive advice requirements for the latter. There are two reasons for that decision.

7.152 First, the proposed flexible advice requirement would largely have mirrored the existing requirements for short leases, and would therefore have resulted in little change in the regime governing these types of transaction.

7.153 Second, very few consultees commented on the current advice requirements for mortgages and for short leases. Consultees' criticisms of the Part 7 regime was not aimed at those requirements. Some consultees actively discouraged altering the current requirements which "work well in practice and do not need changing in any way. Any alteration of these would cause confusion instead of focussing the trustees' attention on the key points to be considered when charging a property".<sup>529</sup> Bircham Dyson Bell LLP and Stewardship similarly supported the advice requirements for mortgages.

#### Advice concerning loans and advice concerning grants

7.154 The CLA noted that the advice requirement for mortgages applies irrespective of whether the mortgage is to secure a loan (which is always intended to be repaid) or to secure a grant (which is not intended to be repaid but which becomes repayable in the event that certain conditions of the grant are not satisfied). Some CLA members considered it illogical for the advice requirements to apply to mortgages to secure grants since – unlike a loan – it is assumed that a grant will not be repaid. Others thought the advice requirement was just as important since "the results for the charity of default can be the same as for a loan". They suggested that the drafting of the statute could be changed to recognise the difference.

7.155 There is clearly a difference between mortgages to secure loans and mortgages to secure grants, but we do not see a particular problem with the advice requirements that apply to both. We think that it is useful, for example, to obtain advice on the charity's ability to repay the sum secured in both cases. The way in which the trustees consider that advice, and its relevance to the decision to agree the mortgage, will differ in both cases, but the advice remains useful.

#### Short leases: assignment and surrender

7.156 It was suggested during consultation that it is anomalous that the grant of a short lease is subject to less onerous advice requirements, but that the surrender or assignment of a short lease is not (and is treated in the same way as other disposals). It was suggested that the same advice requirements should apply to a surrender or assignment of a short lease. We can see the strength of that argument; in many cases, the assignment or surrender of a short lease will be no more complicated or valuable than the grant of a short lease. However, we think that there is a distinction between the two types of

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<sup>529</sup> Bates Wells Braithwaite.

transaction, and are not persuaded that the reduced advice requirements for the grant of a short lease should apply to the assignment or surrender of a short lease.

7.157 It is important to keep in mind that the reduced advice requirements turn not only on the length of the lease (under seven years) but on whether or not it was granted *for a premium*.<sup>530</sup> The reduced advice requirements apply when a charity, as *landlord*, is granting a short lease for a periodic rent (and not for a one-off initial premium). Relevant advice will be on the market rent, which is something on which (for example) an estate agent might be able to provide suitable advice.

7.158 Contrast this with the surrender or assignment of a lease, which involves a charity, as *tenant*, divesting itself of the lease. This requires identifying the capital value of the charity's interest in the property, which might be reflected in a premium or reverse premium. This is a more complicated valuation than determining the market rent.

7.159 For example:

- (1) Lease A is granted for a term of six years at an annual rent of £5,000 (the market rent for the property). The reduced advice requirements for short leases apply.
- (2) Lease B is granted for a term of six years, for a premium of £30,000 and a nominal annual rent (or ground rent) which does not represent the market value of the property. The reduced advice requirements *do not* apply.

7.160 Taking Lease A, despite the lease being granted at market rent and without the payment of a premium, on surrender or assignment a premium might nevertheless be paid. This brings the case closer to Lease B and the associated complexities of having to value the premium. The following scenarios illustrate some potential complexities in valuing a premium.

- (1) There may have been a rise in rental values since the lease was granted so that the market rent at the time of assignment is significantly higher than at the time of the grant. The assignment (on the same terms as the grant) will be beneficial to the assignee, who would otherwise have to pay the higher market rent to obtain the grant of an equivalent new lease. The charity tenant therefore has a valuable asset, and would ordinarily expect the assignee to pay a premium to reflect that fact.
- (2) In the reverse scenario, where there has been a fall in rental values, the lease is a liability to the charity: it is paying more than it would on the grant of an equivalent new lease, as would be any assignee. The charity would therefore ordinarily be expected to pay a reverse premium to the assignee to reflect that fact.
- (3) In either scenario (1) or (2) if the charity wished to surrender its lease a similar premium would be expected to be paid by or to the landlord.

7.161 These are just a few examples of the complexities which could arise on assignment and surrender. Others could include where the charity under the lease has security of tenure

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<sup>530</sup> See para 7.16(2). The language used by the Charities Act 2011 is "in consideration of a fine".

under Part II of the Landlord and Tenant Act 1954 which would permit it to request a new lease at the end of the term; or where the lease contains a rent-review clause.

7.162 We think that these potential complexities on assignment and surrender of leases (including short leases) – which do not arise when a charity as landlord grants a short lease – justify application of the default rule that advice from a designated adviser should be obtained.<sup>531</sup>

### Legacy cases

7.163 We noted dissatisfaction with the application of Part 7 to land which is left to charities in a will in paragraphs 7.59 to 7.62 above. There was a call from consultees to remove legacy cases from the scope of the Part 7 regime altogether. We heard from the Institute of Legacy Management and Cancer Research UK who impressed on us the importance of encouraging (or at least not discouraging) legacy gifts to charities. They were concerned that an overly burdensome legal regime could make charity legacy donations less attractive to potential donors.

7.164 The concerns expressed by the Institute of Legacy Management and Cancer Research UK led us to consider recommending reform specific to legacy cases. However, we ultimately decided against such tailored reform, concluding that our other recommendations (in particular with regard to multiple beneficiaries, on which see paragraph 7.177 below) would alleviate the majority of concerns. In reaching this conclusion we have tried to balance the concerns raised with us in respect of legacy cases against the need to protect charities from dispositions of land at an undervalue which in themselves pose a reputational risk to the charity sector.

### The problem

7.165 We noted above that in legacy cases the beneficiary charities rarely become the legal owners of property left under a will, meaning that their interest does not appear on the register of title. There were four main criticisms of the application of Part 7 to legacy cases.

- (1) We have been told that in practice there is significant non-compliance with Part 7 in legacy cases, sometimes intentionally but also through inadvertence. This stems from the lack of a restriction on the register which would usually prevent completion of a disposition of (registered) charity land without a certificate of compliance with Part 7.
- (2) Part 7 applies inconsistently to legacy cases. Compliance with Part 7 is required where the property being disposed of is “held by or in trust for a charity”. That in turn depends on the form of the gift (whether it is a specific bequest or a residuary gift) and how the personal representatives deal with the property in administering

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<sup>531</sup> Consultees might instead have been suggesting that the reduced advice requirements should apply to the assignment and surrender of leases where the charity is the landlord (rather than the tenant). If a charity's tenant assigns a lease, Part 7 will not apply in any event since an assignment by the tenant is not a disposal of charity land by the landlord. As for surrender, the considerations set out in para 7.160 apply; the charity as landlord might expect to pay or receive a premium in return for the surrender of a lease from a tenant. Advice from a designated adviser should similarly be the default position.

the estate (whether they transfer or “appropriate”<sup>532</sup> the property to the charity before sale).

- (3) Part 7 applies inconsistently in cases where a property (or a residuary gift containing a property) is left to multiple beneficiaries, including a charity or charities. As noted above, while these problems usually arise in legacy cases because property is often left by will to multiple beneficiaries, it is not limited to such cases.
- (4) The Institute of Legacy Management and Cancer Research UK argued that surveyors’ reports obtained to comply with Part 7 provide no added value in the legacy context. The reports are usually sought after the personal representatives have already accepted an offer on the property and the report essentially serves as a rubber stamp on a pre-agreed transaction. This is particularly the case for charities, such as Cancer Research, who have experienced legacy teams in house who verify the terms of proposed sales of legacy property.

#### Options for reform

7.166 Our discussions with stakeholders revealed two potential reform options to address the issues in legacy cases.

- (1) The Institute of Legacy Management advocated for legacy cases to be exempt from Part 7 altogether. While we can see the strength of this argument, we are not convinced that it would be practical or appropriate.
  - (a) First, there is a risk that removing legacy cases from Part 7 would create a lacuna in the legal protection of charity land. A decision to sell before appropriation is made by the personal representatives,<sup>533</sup> so their general duties would apply to ensure that a reasonable price is obtained. However, after appropriation, the decision to sell rests with the charity and the duty to obtain the best terms falls on the charity trustees. Part 7 is designed to ensure that charities comply with that duty. To remove legacy cases from Part 7 would leave disposals of charity land (post-appropriation) unprotected by (1) the duties of personal representatives and (2) the Part 7 duties on charity trustees.
  - (b) Second, and related to the first point, not all charities receiving legacies are large charities with dedicated and professional legacy officers. We are conscious that we have heard from the Institute of Legacy Management, which represents the largest legacy-receiving charities, and whose own internal procedures may ensure that legacy property is sold on the best terms. But many charities receiving legacies will be small with

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<sup>532</sup> Appropriation is “the process whereby a representative uses a specific asset to meet in full or in part the pecuniary entitlement of a beneficiary”. See *Williams, Mortimer and Sunnucks on Executors, Administrators and Probate* (20<sup>th</sup> ed 2015) para 55-54. Appropriation transfers at least the beneficial interest in a particular asset, if not always the legal title.

<sup>533</sup> Even though, we are told by the Institute of Legacy Management, personal representatives will often consult with, or even seek the consent of, the charity before agreeing to the sale.



inexperienced trustees; to exclude disposals of such property from Part 7 would remove the existing protection of charity land.

- (c) Third, many of the criticisms of Part 7 in the legacy context were made by other consultees in the broader context of dispositions of charity land.<sup>534</sup> It is hard to justify an exemption in the legacy context as distinct from the broader context.
  - (d) Fourth, the existing exemptions from Part 7 generally involve cases where there is alternative protection of charity land (for example, a transaction which is authorised by the Minister under the Universities and College Estates Act 1925, or sale by a liquidator who is subject to separate duties which should ensure charity land is not sold at an undervalue).
- (2) We considered creating an exemption from Part 7 in cases where the charity is not the decision maker (because the disposal is being made by the personal representative without the consent of the charity trustees). We foresaw various problems with this approach.
- (a) From a practical perspective, it would be difficult to define when a charity is making the decision to dispose of the property.
  - (b) The Institute of Legacy Management told us that, in practice, a charity is involved, or making the decision, in the vast majority of legacy cases. Therefore, a decision-based application of Part 7 risks expanding the regime to cases to which it would not currently apply.
  - (c) We also heard from stakeholders that charities want to be involved in the decision to dispose of land left to them in a will. A decision-based approach could encourage personal representatives to exclude charities from decisions in order to avoid the burdens of complying with Part 7.

7.167 For these reasons we do not recommend any statutory exemptions from Part 7 to cater for legacy cases. Instead, we make four responses to the concerns of stakeholders in relation to legacy cases.

(1) Clarifying the legal position: application of Part 7 in legacy cases

7.168 Part 7, in its current form, applies in all situations where land is “held by or in trust for a charity”. In the legacy context, therefore, Part 7 applies in any situation where legal title or a beneficial interest has been transferred to a charity by the personal representatives by conveyance, assent or by appropriation (deemed or express). It has been suggested that Part 7 applies when property has been specifically devised to a charity, even before the personal representatives have assented or appropriated the property to the charity. Since a legatee does not have a beneficial interest in the property until assent or

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<sup>534</sup> See, for example, the criticism that Part 7 reports are a rubber stamp and do not add value: para 7.50 above.

appropriation,<sup>535</sup> we do not consider the land is “held by or in trust for a charity” within the meaning of Part 7. In so far as charities currently seek to comply with Part 7 in such cases, we do not think that they need continue doing so.

7.169 We are not making a recommendation to address deemed appropriation cases where personal representatives sell land without the charities’ knowledge. Following further discussion with Cancer Research UK, who raised this issue, we believe it may be an academic question which rarely arises in practice. Furthermore we do not think these cases will create real practical problems since the charity’s non-compliance is not blameworthy (from the charity’s reputational point of view) and does not invalidate the sale (from the purchaser’s point of view).

(2) Effect of other proposed reforms to Part 7 on legacy cases

7.170 In this chapter, we make various recommendations to reform the Part 7 regime to reduce the burden and expense of compliance, which was a major criticism of the regime in general. We hope that those recommendations will be beneficial in legacy cases. Our recommendations would simplify the Part 7 advice requirements, expand the category of designated advisers, enable charities to rely on in-house expertise (if available) to comply with Part 7, and enable greater delegation of compliance with Part 7.

(3) Tailored dispensation from the Part 7 requirements

7.171 We understand that some large charities receive a large number of legacies and they have internal processes – based on years of experience – to ensure that good value is obtained when those properties are sold. We therefore understand their frustration in having to comply with an additional layer of process in Part 7, which is aimed at ensuring the same outcome. We reject above a power to dispense with the Part 7 advice requirements, as well as other exemptions based on the size of charity or the type or value of the property. We have concluded that the value of Part 7 in protecting inexperienced charities from dispositions at an undervalue outweighs the burden on some charities that do not need this protection. This conclusion applies equally to legacy cases.

7.172 Nonetheless, we mention above the ability of charities to apply to the Charity Commission for dispensation from the Part 7 advice requirements (paragraphs 7.143 and 7.144). We think that this could be beneficial in the legacy context, particularly for larger charities which may be able to demonstrate to the Charity Commission that they have sufficient internal safeguards that can replace the protection provided by Part 7. It might be that a representative group, such as the Institute of Legacy Management, could devise – in conjunction with the Charity Commission – a model application for dispensation which could then be used by Institute of Legacy Management members.

(4) Reform to Part 7 for multiple beneficiary cases

7.173 We set out below our recommendation for reform to Part 7 which will address all cases in which land is held by or in trust for more than one charity, or for both a charity and a

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<sup>535</sup> Legatees under a will are not beneficiaries; they have an inchoate right to ensure that the estate is properly administered, but no beneficial interest: *Williams, Mortimer & Sunnucks on Executors, Administrators and Probate* (20<sup>th</sup> ed 2015), paras 41-05 and 81-01.

non-charity. This recommendation will alleviate a number of concerns which arise in the legacy context.

### Recommendations for reform of the advice requirements

7.174 Having analysed numerous criticisms and options for reform we now set out our final recommendations for reforming the Part 7 advice requirements.

#### Recommendation 14.

7.175 We recommend that:

- (1) the category of designated advisers under Part 7 of the Charities Act 2011 be expanded to include fellows of the National Association of Estate Agents and fellows of the Central Association of Agricultural Valuers;
- (2) qualified charity trustees, officers and employees be able to give advice under sections 119(1)(a), 120(2)(a) and 124(2) of the Charities Act 2011; and
- (3) the Charities (Qualified Surveyors' Reports) Regulations 1992 be replaced with regulations that require designated advisers to provide:
  - (a) advice concerning:
    - (i) what sum to expect (or, if an offer has already been made, whether the offer represents the market value of the land);
    - (ii) whether (and, if so, how) the value of the land could be enhanced;
    - (iii) marketing the land (or, if an offer has already been made, any further marketing that would be desirable);
    - (iv) anything else which could be done to ensure that the terms of the transaction are the best that can reasonably be obtained for the charity; and
  - (b) a self-certification by the adviser that they:
    - (i) have the appropriate expertise and experience to provide the advice that is required;
    - (ii) do not have any interest that conflicts, or would appear to conflict, with that of the charity; and
- (4) the statutory requirement that charity trustees advertise the proposed disposition in the manner advised in the surveyor's report be removed.

7.176 Our recommended reforms to the Part 7 advice requirements would be given effect by implementation of:

- (1) clauses 20, 21 and 22 of the draft Bill;
- (2) the draft Charities (Designated Advisers) Regulations at Appendix 5; and
- (3) the draft Charities (Designated Advisers' Reports) Regulations also at Appendix 5.

## **MULTIPLE BENEFICIARIES**

### **Policy underlying Part 7**

7.177 In considering criticisms of the advice requirements we discussed issues which arise in complying with Part 7 where property is held by or in trust for multiple beneficiaries, one or more of which is a charity (both in the legacy context and otherwise). In considering how to address these issues, it is noteworthy that the policy aim underlying the general prohibition on dispositions of charity land is to protect a particular charity's assets against a disposition at an undervalue by *its own trustee(s)*.

7.178 This aim is not engaged where land is held by or in trust for several beneficiaries (of which one or more are charities) because it is not any individual charity's asset that is being disposed of by its charity trustees alone. Several entities have an interest in the property in question which will ultimately be disposed of by the trustee of the land, who must, according to their general duties, act in the best interests of the beneficiaries.

7.179 Furthermore, it seems odd to force charity trustees to seek and consider advice on the terms of a disposition which they do not ultimately have control over because the power of sale lies with the trustee of the land. Even if the charity is the trustee, or one of the trustees, of the land (and therefore has complete, or some, control of the disposal), we do not think that it is appropriate to subject the charity to the Part 7 regime. In such a case, the charity should be making a decision in its capacity as the trustee of the trust of land, not in its capacity as the owner for charitable purposes of part of the beneficial interest under that trust of land. Part 7 is focussed on the best terms for the charity,<sup>536</sup> but where land is held on trust for multiple beneficiaries the disposal decision by the trustee(s) should be about what is in the best interests of all the beneficiaries, not about what is in the best interests of one of those beneficiaries.

### **Clarifying the definition of "charity land"**

7.180 We have therefore concluded that cases where land is held by or in trust for multiple beneficiaries should be excluded from the Part 7 regime altogether. In order to do so, we recommend clarifying the definition of "land held by or in trust for a charity" which is currently subject to conflicting interpretations on this issue. Our recommendation is that the restrictions on dispositions of land should apply only to land (or an interest in land) held beneficially by a charity *solely* for its own benefit (if it is a corporate charity) or in trust *solely* for that charity (if it is an unincorporated charity). The Part 7 regime would

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<sup>536</sup> See, in particular, s 119(1)(c).

not, therefore, apply when the land being disposed of is held on trust for two or more beneficiaries, some or all of whom are charities.

7.181 The result of our recommendation would be that:

- (1) Part 7 would continue to apply where:
  - (a) a charity owns land both legally and beneficially;
  - (b) a trustee holds land on bare trust for a single charity;
  - (c) land is left to a charity in a will and the executor has appropriated the land to a charity; or
  - (d) a charity owns land as one of several tenants in common and it is disposing of its beneficial interest in the land (that is, its percentage share of the land).

In each of these cases, the charity controls the disposal, and the charity can sensibly be required to comply with Part 7 by obtaining advice on the disposal.

- (2) Part 7 would not apply where:
  - (a) a charity is one of several beneficial joint tenants of land and the entirety of the land is being disposed of by the trustee of the land;
  - (b) a charity is one several tenants in common of the land and the entirety of the land is being disposed of by the trustee of the land;
  - (c) land is left to, and appropriated or assented to, multiple beneficiaries in the execution of a will, one or more of which is a charity; or
  - (d) a trustee holds land on trust for multiple beneficiaries, one or more of which is a charity.

In each of these cases, the charity does not (alone, at least) control the disposal, and it is not appropriate to require the charity to obtain advice under Part 7 on the disposal.

7.182 Our recommendation would remove the concern that an adviser must act “exclusively for the charity” because Part 7 will only be engaged in cases where the property or interest in a property being disposed of is held solely by or in trust for a single charity. Similarly, it removes potential problems where the best terms for one charity are not the best terms for another. Such issues will now fall to be addressed by the general law governing trusts of land which is better suited to resolving such disputes.<sup>537</sup>

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<sup>537</sup> For example, by provisions in the Trusts of Land and Appointment of Trustees Act 1996.

### **Recommendation 15.**

7.183 We recommend that Part 7 of the Charities Act 2011 only apply where land is solely held by, or held in trust solely for, a single charity.

7.184 Clause 17 of the draft Bill would give effect to this recommendation.

## **CONNECTED PERSONS**

### **Should the provisions concerning connected persons be retained?**

7.185 Part 7 prohibits the disposal of charity land to any person falling within the definition of “connected person”, without the consent of the Charity Commission (or the court).<sup>538</sup> There is no similar prohibition on the creation of a mortgage in favour of a connected person.

7.186 In the Consultation Paper, we said that the general law already prevents charity trustees from entering into transactions with people with whom they are associated, since to do so would amount to a breach of their fiduciary duties.<sup>539</sup> That is why there is no similar statutory regime for the disposal of other assets such as personal property, shares, or intellectual property to connected persons. Such disposals are prevented by the general law. Disposals in breach of that prohibition are not void, but could be avoided – like any other disposal in breach of trust – if made at an undervalue or otherwise not in the interests of the charity. And if trustees wish to make such disposals, in the absence of an express power in their governing document, they could seek Charity Commission authorisation under section 105 of the Charities Act 2011. The provisions about connected persons in Part 7 are therefore arguably unnecessary.

7.187 Further, we said that the connected persons provisions may be unhelpful since they may encourage a belief that trustees are safe to dispose of property to someone with whom they are associated but who does not fall within the statutory definition of “connected person”. But just because a disposal is not to a “connected person” does not mean that trustees are safe to make the disposal if there would otherwise be a potential conflict of interest. For example, if the donee is an aunt or uncle, or a person in negotiations with a trustee for a proposed business venture, they would not be a “connected person” but a disposal to such a person may be a breach of fiduciary duty.

7.188 Whilst we acknowledged the benefits of the regime, we said that the Charity Commission already produces general guidance on managing conflicts of interest, which applies to all charity transactions,<sup>540</sup> and that there was no need for a statutory regime governing connected persons in the case of land disposals. We therefore

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<sup>538</sup> See para 7.18.

<sup>539</sup> See generally Ch 9.

<sup>540</sup> Charity Commission, *Conflicts of interest: a guide for charity trustees* (CC29) (May 2014) available at <https://www.gov.uk/government/publications/conflicts-of-interest-a-guide-for-charity-trustees-cc29>; and Charity Commission, *Trustee expenses and payments* (CC11) (March 2012) available at <https://www.gov.uk/government/publications/trustee-expenses-and-payments-cc11>.

provisionally concluded that the provisions concerning connected persons should be repealed.<sup>541</sup>

7.189 There was a lack of consensus amongst consultees on this question. The CLA effectively summarised the issue:

We think the central question is whether it is considered necessary to have a separate “alert” to charity trustees in particular circumstances and, if so, how such “alert” process should be effected, without detracting from the usual duties applicable to charity trustees.

7.190 Consultees who agreed with our proposal to repeal the provisions pointed to the gaps in the current definition of connected person and to the risks of the regime creating a “tick-box” mentality. Consultees who disagreed were concerned that trustees would not sufficiently understand the general law, pointing to the benefits of clear provisions in statute rather than “having to be aware of the nuances of the general law”.<sup>542</sup> They feared that there would be an increase in the number of transactions where conflicts were not properly managed.

7.191 Consultees did not give examples of the provisions failing to capture transactions where a conflict existed. Consultees’ criticisms of the regime were based on the definition of connected persons being unnecessarily wide and the time that it takes to obtain Charity Commission consent to a transaction with a connected person.

7.192 Some alternative suggestions for reform were made by consultees.

- (1) It was suggested that the trustees should be required to certify in the Part 7 certificate that the transaction did not involve a conflict of interests. This suggestion is similar to the proposal that the advice requirements should be replaced with a Part 7 certificate confirming that the trustees had complied with their duties (see paragraphs 7.111 to 7.113). For the reasons we gave there, we do not agree with the suggestion.
- (2) It was suggested that the trustees should be required to certify in the Part 7 certificate that they had had regard to Charity Commission guidance concerning conflicts of interest. Again, this suggestion is similar to the proposal that the advice requirements should be replaced with a Part 7 certificate that the trustees have had regard to guidance on the disposal of land (see paragraphs 7.114 to 7.116). For the reasons we gave there, we do not agree with the suggestion.
- (3) It was suggested that the list of connected persons could include an additional category of persons, namely anyone with whom a transaction would present a conflict of interests. The difficulty with this approach, in our view, is that it undermines the simplicity of the connected persons definition.

7.193 We have concluded that the connected persons provisions in Part 7 should be retained. The requirement for Charity Commission consent provides a statutory scheme to

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<sup>541</sup> Consultation Paper, para 8.68.

<sup>542</sup> Canal & River Trust.

manage conflicts of interest by capturing a wide range of transactions where a conflict might arise. It ensures that, in those defined cases, the charity obtains the best terms in respect of such transactions. The provisions are a helpful alert and they slot neatly into the general prohibition on land disposals, enforced by the mechanism of the restriction on the register. The provisions are not a complete statement of the law; they round some corners. But they are simple, they are generally easy to apply, and they draw attention to the importance of managing conflicts of interest. We think it important, however, for the Charity Commission's guidance to emphasise that, just because the person to whom a proposed disposition is to be made is not on the statutory list of connected persons does not mean that there is no conflict of interest.

7.194 There is no equivalent regime for mortgages to connected persons, or the acquisition of land from connected persons. A mainstream mortgage with a commercial lender is unlikely to present conflict issues. A mortgage with a connected person would be rare and trustees are likely already to appreciate that it would be an unusual transaction. We therefore think that mortgages with connected persons are sufficiently covered by trustees' general duties without the need to extend the connected persons provisions; creating connected persons provisions for mortgages would be disproportionate regulation to cater for a very rare occurrence. As for the acquisition of land, there is no mechanism equivalent to the restriction on the register to which connected persons provisions could be attached; we think that the acquisition of land from connected persons should, like all other transactions, be left to the general law and to existing Charity Commission guidance on conflicts of interest.

7.195 In conclusion, we are not inclined to extend the connected persons regime to mortgages, but on balance we favour retention of the existing provisions. While we do not think that we would include the connected persons provisions if we were designing Part 7 from scratch, we are concerned that removing them now might suggest that there has been a change in the law and that dispositions to such persons are permitted. We are also conscious that smaller charities may find it useful to have a statutory list of persons to whom transactions are prohibited as an alert to potential conflicts of interest.

### **The definition of connected persons**

7.196 In the event the connected persons provisions were retained, the Consultation Paper proposed that the definition should be changed in two ways. As a preliminary point, we should emphasise that transactions with connected persons are not completely prohibited. Rather, they require Charity Commission consent.

#### **Wholly-owned subsidiaries**

7.197 Where a charity makes a disposal to a wholly-owned trading subsidiary, the subsidiary seems to fall within the definition of "connected person" and the Charity Commission's consent to the disposal is therefore required (although Bircham Dyson Bell LLP did not interpret the existing definition as including a wholly-owned subsidiary). Such disposals could occur during a restructuring process, or where a charity owns a retail unit and wishes to grant a lease to its trading subsidiary which will operate a retail business from the unit.



7.198 In the Consultation Paper, we said that including a wholly-owned subsidiary within the definition seemed unnecessary, given that any benefit to the subsidiary from a disposal will be enjoyed by the charity as its owner.<sup>543</sup> We proposed that wholly-owned subsidiaries should not fall within the definition of “connected persons”.<sup>544</sup>

7.199 Almost all consultees agreed. Some raised concerns, which fall into two broad categories. First, Stone King LLP noted the possibility of land being transferred to a wholly-owned subsidiary and then the subsidiary becoming a development vehicle or its shares being sold. They added that the directors of a subsidiary are often officers and not trustees, so the trustees can lose sight of the subsidiary’s activities. We acknowledge this concern, which ought to be given careful consideration by trustees when they are deciding whether it would be in the charity’s interests to transfer land away from the charity into a subsidiary company. The trustees would have to weigh these and other risks against the benefits of operating a trading subsidiary.<sup>545</sup> But ultimately, in our view, the connected persons provisions in Part 7 are not intended to guard against such future risks, but rather to prevent persons with interests that potentially conflict with the interests of the charity from acquiring charity land on unsuitable terms.

7.200 Second, some consultees emphasised that transactions with subsidiaries should still be for market value. The Charity Commission told us that there can be a lack of understanding about the distinction between charities and their trading subsidiaries, with the result that those making the decision to dispose of the charity’s land sometimes consider the subsidiary’s interests in place of the charity’s, or fail to manage conflicts of interest appropriately.<sup>546</sup> The requirement for Charity Commission consent can therefore prevent disposals of charity land to subsidiaries on terms that are not the best that can be obtained by the charity. In addition, the requirement for consent can allow the Commission to identify the minority of disposals that are illegitimate.

7.201 The effect of the current regime is that charities must seek the consent of the Charity Commission to all disposals to subsidiaries, which takes time and therefore delays transactions, even though the majority of such disposals are unexceptionable and so are ultimately approved by the Commission. We think it is disproportionate to require all disposals to subsidiaries to be delayed pending a Charity Commission decision for the sake of capturing the minority of transactions which are problematic. We have concluded that disposals of land to wholly-owned subsidiaries should not require Charity Commission consent, but that trustees should instead be required to notify the Commission of such disposals after they have taken place (and within 14 days of taking place). As we go on to explain, we think that this approach is a more proportionate way of seeking to prevent inappropriate transactions.

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<sup>543</sup> This point was raised in para 10.18 of the Hodgson Report.

<sup>544</sup> Consultation Paper, para 8.70.

<sup>545</sup> For example, the advantage of the charity’s remaining assets being protected in the event that the trading subsidiary fails and becomes insolvent. There are also tax benefits as a charity does not pay tax on profits made from trade if they are made through a subsidiary trading company.

<sup>546</sup> See Charity Commission, *Trustees trading and tax: how charities may lawfully trade* (CC35) (February 2016), available at <https://www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35>.

7.202 Removing wholly-owned subsidiaries from the definition of connected persons would leave in place the requirement under Part 7 to obtain advice on the value of the land from a designated adviser. Moreover, there would remain a requirement for the charity trustees to be satisfied that the terms of the disposition “are the best that can reasonably be obtained for the charity”.<sup>547</sup> We think that both the Charity Commission’s guidance for trustees disposing of land,<sup>548</sup> and guidance for designated advisers issued by their professional regulators,<sup>549</sup> should include an explanation that this general requirement still applies, even if a disposal is to a wholly-owned subsidiary.

7.203 We think that, by requiring charities to notify the Charity Commission of disposals to wholly-owned subsidiaries, charities will be incentivised to ensure that transactions with subsidiaries are at arm’s length because they will know that the transaction is subject to potential scrutiny by the Commission. And if disposals are somehow inappropriate or disadvantageous for the charity, the Charity Commission could exercise its regulatory powers in respect of the charity, which could include steps to seek to reverse the transaction.

#### Employees of a charity

7.204 Some consultees commented that the inclusion of employees of a charity caused problems, particularly when a charity wishes to provide an employee with accommodation by way of an assured shorthold tenancy.<sup>550</sup> We agree that the provision of accommodation, including at below market rent, might be in the interests of the charity by facilitating the employee’s work. But there are equally potential situations when an overbearing senior employee of a charity might seek to persuade the trustees to dispose of land to him or her (or a family member) at an undervalue.

7.205 We do not therefore think that employees should be excluded from the definition. Instead, we recommend that an exception be made in respect of residential tenancies granted to employees for a term of one year or less. For situations not falling within this exception we would encourage charities that find themselves routinely providing staff accommodation (or making other disposals to employees of the charity) to seek general authorisation from the Charity Commission within appropriate limits, such as:

- (1) authorisation in respect of particular properties;
- (2) authorisation in respect of particular transactions (for example, leases of up to a certain length); and/or
- (3) a requirement for a decision to be made by non-conflicted trustees that the disposal is in the interests of the charity.

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<sup>547</sup> Charities Act 2011, s 119(1)(c).

<sup>548</sup> Charity Commission, *Sales leases transfers or mortgages: what trustees need to know about disposing of charity land* (CC28) March 2012.

<sup>549</sup> Namely, RICS, NAEA and CAAV; see paras 7.133 to 7.139 and 7.175(1) above.

<sup>550</sup> Most residential tenancies are assured shorthold tenancies, protected by the Housing Act 1988.

## Family members

7.206 The CLA pointed out that, whilst step-children were included, step-siblings were not. We were inclined to expand the definition of connected persons to include step-relationships. However, in exploring this issue further we discovered that the Charities Act is silent as to whether a step-relationship must be by marriage (or civil partnership) or includes by cohabitation. We also discovered some inconsistencies in the current list of connected persons in that some relationships are included but the reciprocal relationship is not, for example, a sibling's spouse is a connected person, but a spouse's sibling is not. There are also some arguably close family relationships that are not included in the list: cousins, aunts, uncles, nieces and nephews.

7.207 Various other Acts include inconsistent statutory definitions of connected persons. We have concluded that there are inherent difficulties in setting out a comprehensive list of close family relationships in primary legislation. Family structures vary enormously and while in one case a trustee's step-grandchild-in-law might be very close to them, raising conflict of interest issues, in another they may be completely estranged and far less likely to cause a conflict of interest than a disposal to, say, a close friend.

7.208 As we explained above, the connected persons provisions contained in the Charities Act are not an exhaustive list of all persons to whom disposing of property may constitute a breach of trust. The list is useful as an alert to trustees of certain cases where they will need to justify the disposition to the Charity Commission and the general law governing trustees' duties exists to fill in any gaps.

7.209 We do however recommend that the connected persons provisions be capable of amendment by secondary legislation.<sup>551</sup> We hope that this will be a more suitable vehicle for making changes; if particular problems arise, the definition can be amended to address them, or it would be possible to undertake a focussed review in order to try to produce a more comprehensive, modern list of relevant family relationships.

7.210 Finally, the connected persons provisions currently refer to an "illegitimate child".<sup>552</sup> This language is outdated and no longer necessary as section 1 of the Family Law Reform Act 1987 provides that all statutory references to a relationship between two persons shall be construed without reference to whether or not the father and mother of either of them have ever been married. We therefore recommend that it be omitted.

## Other suggestions

7.211 Two further suggestions to amend the definition of connected persons were made by consultees.

7.212 First, some consultees wanted to remove donors of land from the definition. We think that conflicts of interest, and a risk of disposals at an undervalue, arise in the case of disposals to donors (and their families) and we think that Charity Commission oversight of such transactions should continue.

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<sup>551</sup> This was suggested by Stone King LLP.

<sup>552</sup> See Charities Act 2011, s 350(1).

7.213 Second, the definition includes “a trustee for the charity” who is not also a “charity trustee”.<sup>553</sup> We said in the Consultation Paper that this wording includes a holding trustee and others who hold legal title to property, but must comply with the directions given to them by another such as the charity trustees. We said that where a third party holds legal title for a charity subject to the direction of the charity trustees, the risk is minimal, and they should be excluded from the definition. Whilst most consultees agreed, some pointed out that a trustee for the charity could have significant influence and there was therefore potential for land to be sold to such a person at an undervalue. For example, Bates Wells Braithwaite said that a national charity that acts as a holding trustee for properties of local charities should be covered by the connected person provisions since it might have significant influence over the operations of those local charities. We agree that in such cases there is a real risk of conflicts of interest resulting in transactions at an undervalue and we therefore recommend retention of “a trustee for the charity” in the definition of connected persons.

**Recommendation 16.**

7.214 We recommend that:

- (1) the connected persons regime in Part 7 of the Charities Act 2011 be retained;
- (2) the definition of connected persons should:
  - (a) exclude employees where the disposal is the grant of a short residential tenancy;
  - (b) exclude wholly-owned subsidiaries;
  - (c) be capable of amendment by secondary legislation; and
  - (d) omit the reference to “illegitimate child”;
- (3) disposals of land to wholly-owned subsidiaries should be notified to the Charity Commission; and
- (4) the Charity Commission’s guidance for trustees disposing of land, and guidance for designated advisers, should make clear that disposals to wholly-owned subsidiaries should be for the best terms that can reasonably be obtained for the charity.

7.215 Clauses 25, 42, and 43 of the draft Bill would give effect to this recommendation.

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<sup>553</sup> Charities Act 2011, s 118(2)(a). “Charity trustees” means the persons having the general control and management of the administration of a charity: Charities Act 2011, s 177.

## DELEGATION

### Obligations on the charity trustees

7.216 Part 7 imposes various requirements on transactions involving charity land. For small charities, the requirements will be complied with by the charity trustees personally. For larger charities, many requirements can be complied with by the charity's staff. For example, the obligation on the charity trustees to advertise a disposition in accordance with a RICS surveyor's advice<sup>554</sup> can be satisfied by the charity's staff ensuring that the advertising is carried out. Other obligations might suggest that they must be performed by the charity trustees personally:

- (1) the charity trustees must obtain "and consider" a report from a RICS surveyor;<sup>555</sup>
- (2) the charity trustees must "reasonably believe" that the RICS surveyor has the appropriate ability and experience to value the land;<sup>556</sup>
- (3) the charity trustees must "decide that they are satisfied" that the terms of the disposal are the best that can reasonably be obtained;<sup>557</sup> and
- (4) the charity trustees "must certify" in the conveyance that the Part 7 requirements have been complied with.<sup>558</sup>

7.217 Some consultees commented that these decisions should be capable of delegation by the charity trustees to a sub-committee of trustees or to employees of the charity. Trowers and Hamlins LLP said that some charities with large land holdings are routinely acquiring and disposing of land; "smaller, routine transactions ought to be capable of delegation in order to permit the trustees to remain focussed on matters of strategic importance". The Institute of Legacy Management reported that 86% of respondents to its survey of its members thought that legacy officers were better placed than trustees to make decisions about the sale of legacy property, and 98% of respondents said that trustees should be able to delegate all decisions relating to the sale of legacy property.<sup>559</sup> Most respondents said that, in practice, decisions were already delegated and "the involvement of trustees in property disposals is kept to a minimum".

7.218 We agree that charity trustees should have the flexibility to delegate the four matters set out in paragraph 7.216. We do not think that the Charities Act currently requires trustees to comply with those matters personally. We appreciate consultees' concerns that the position is currently unclear, but inserting a provision to address the point would be difficult. As we consider that delegation is already possible, we would not want reform

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<sup>554</sup> Charities Act 2011, s 119(1)(b).

<sup>555</sup> Charities Act 2011, s 119(1)(a). There is an equivalent obligation on the charity trustees in respect of short leases (s 120(2)(a)) and mortgages (s 124(2) and (7)).

<sup>556</sup> Charities Act 2011, s 119(3)(b). There is an equivalent obligation on the charity trustees in respect of short leases (s 120(2)(a)) and mortgages (s 124(8)(a)).

<sup>557</sup> Charities Act 2011, s 119(1)(c). There is an equivalent obligation in respect of short leases: s 120(2)(b).

<sup>558</sup> Charities Act 2011, s 122(3). There is an equivalent obligation in respect of mortgages: s 125(2) and (6). There are other obligations on the charity trustees to notify the HM Land Registry of certain matters in s 123.

<sup>559</sup> 77 charities responded to the survey, including "each of the 14 biggest charities by legacy income".

to cast doubt on the validity of delegations which have already taken place. We are also aware of many other instances, outside Part 7, where the Act imposes duties on trustees, some of which require them to comply personally, and others which would allow for delegation. Any express provision addressing the point risks casting doubt on the permissibility of delegation in these other contexts.

7.219 We do not think that statutory reform is necessary to allow trustees to delegate the decisions in para 7.216 above; they can already be delegated.

### **The Part 7 certificate**

7.220 A related point raised by consultees was uncertainty as to who was required, or permitted, to give the Part 7 certificate both in respect of corporate and unincorporated charities.

7.221 Bircham Dyson Bell LLP noted an inconsistency under the current regime in the case of disposals by corporate charities. The charity as vendor must execute the conveyance, but Part 7 requires the charity trustees to give the certificate. In practice, that might not matter if the trustees can delegate the giving of the Part 7 certificate to two trustees under the general delegation power in section 333 of the Charities Act 2011. This would mean that the two directors of the charity who sign the conveyance on behalf of the charity<sup>560</sup> can also be authorised to sign the Part 7 certificate. But there is some uncertainty as to whether the provision of a Part 7 certificate can be delegated under section 333.<sup>561</sup> There is further uncertainty as to whether the provision of a Part 7 certificate can be delegated under normal company law rules.<sup>562</sup>

7.222 We agree that, in the case of a corporate charity, the Part 7 certificate should be given by the charity and not by the charity trustees. And as explained above, we think that the execution of a Part 7 certificate, whether by a corporate or unincorporated charity, should be capable of being delegated.

7.223 Our recommendations in relation to Part 7 certificates below resolve this issue by removing the phrase “the charity trustees must certify” from the relevant provisions in Part 7; instead, a statement of compliance would be included in the conveyance, which would be executed in the usual way by the charity, the charity trustee, or their delegates. We therefore make no specific recommendation here. We hope that our recommendations below will alleviate much of the concern regarding delegation more generally as the question of who must provide a Part 7 certificate is one of the instances in which the lack of clarity causes the most difficulties in practice.

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<sup>560</sup> In accordance with normal company law rules: Companies Act 2006, s44.

<sup>561</sup> HM Land Registry Practice Guidance suggests that the provision of a Part 7 certificate can be delegated to two directors under s 333: HM Land Registry, *Practice guide 14: charities* (May 2017) paras 5.2.4, 5.2.5 and 8, available at <https://www.gov.uk/government/publications/charities-advice-for-applications-to-be-sent-to-land-registry/practice-guide-14-charities#execution-by-charity-trustees>. Bircham Dyson Bell LLP queried whether it was possible. Similarly, Veale Wasbrough Vizards LLP said that s 333 was intended for unincorporated charities, not corporate charities. HM Land Registry’s view is that s 333 is generally used by unincorporated charities, but could arguably apply to corporate charities where their constitution permits such delegation, although the position is unclear.

<sup>562</sup> See n 560 above.

## PART 7 CERTIFICATES

### The “*Bayoumi* gap”

7.224 The question in *Bayoumi v Women’s Total Abstinence Educational Union Ltd* (“*Bayoumi*”),<sup>563</sup> in brief, was whether a purchaser in good faith under a contract for the sale of land had the benefit of the protection in section 122(6) of the Charities Act (see paragraph 7.44) when the charity trustees had not complied with the statutory requirements. The answer was that the purchaser was not protected. So whilst purchasers are protected in the case of *dispositions* (that is, the actual sale of land),<sup>564</sup> the effect of the decision in *Bayoumi* is that there is no equivalent protection for *contracts* for sale.

7.225 The precise facts in *Bayoumi* cannot arise again because the relevant statutory provisions (which made a contract unenforceable) have been amended. But the fact remains that if the requirements of Part 7 have not been complied with by the time a contract is made, a purchaser will not be able to enforce it. Essentially the contract will be frustrated because of the failure to comply with the Part 7 requirements. The statute does not provide for a certificate to be given in the contract and any such certificate is not deemed to be correct. Accordingly purchasers who contract to buy, or to take a lease of, land from a charity have to check that the statutory requirements have been complied with. This is onerous, and causes delay and expense.

7.226 We have recommended above the retention of the general prohibition on disposing of charity land such that non-compliance will render a transaction void. The Consultation Paper proposed that, under such a regime, a purchaser should be protected by a certificate, deemed conclusively to be correct, in the contract that the statutory requirements have been complied with.<sup>565</sup> No consultee disagreed. We remain of the view that a purchaser should be protected by a certificate in a contract as well as in a disposition. There is an existing requirement on charities to include certain statements in contracts,<sup>566</sup> and we think that there should be an additional requirement to include a statement that the Part 7 requirements have been complied with.<sup>567</sup> Part 7 should then include equivalent protections for purchasers (a) when such statements are included in contracts, and (b) when such statements are not included but the purchaser has acted in good faith.<sup>568</sup> We agree with those consultees who said that such a statement in a contract should be capable of being given by the person who is authorised by the charity

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<sup>563</sup> [2003] EWCA Civ 1548, [2004] Ch 46, we discuss the facts of *Bayoumi* in the Consultation Paper, para 8.71.

<sup>564</sup> Either because (a) the trustees’ certificate in the transfer or other document effecting a disposition is conclusively presumed to be correct (s 122(4)) or (b) in the absence of such a certificate, a purchaser in good faith is nevertheless protected (s 122(6)).

<sup>565</sup> Consultation Paper, para 8.109.

<sup>566</sup> See para 7.41.

<sup>567</sup> In reality, buyers will already insist on charities providing this confirmation, or will want to see evidence of compliance, before exchange of contracts. Our recommendation would not therefore impose a new burden on charities as vendors; rather, it would provide purchasers with protection when such a certificate is included and therefore eliminate the need for purchasers’ solicitors to check whether the charity vendor had complied with Part 7 before exchange of contracts.

<sup>568</sup> As under Charities Act 2011, s 122(4) and (6) for conveyances.

to sign the contract on its behalf: similarly to the provision of a statement in a conveyance; see paragraph 7.233 above.

### **Recommendation 17.**

7.227 We recommend that:

- (1) charities be required to include in a contract for a disposition of charity land a statement that the requirements of Part 7 of the Charities Act 2011 have been complied with; and
- (2) a contract for a disposition of charity land should be enforceable by a purchaser if:
  - (a) such a certificate has been given in the contract; or
  - (b) such a certificate has not been given but the purchaser has acted in good faith.

7.228 Clause 24 of the draft Bill would give effect to this recommendation.

### **DESIGNATED LAND**

7.229 We explained the requirements for public consultation for dispositions of designated land in paragraph 7.25 and following above. The consultation requirements for designated land seek to ensure that local public opinion is taken into account by trustees before they dispose of such land and ensure some transparency in their dealings. In the Consultation Paper, we said that the requirement was arguably unnecessary since a charity should be considering how its land can best be used to serve its charitable purposes, rather than public opinion about how it should deal with its land (although we noted that the latter may be relevant to the former). We acknowledged that disposal of designated land could be controversial and that consultation could have a valuable role, but we thought that trustees should be left to decide whether to consult as part of their decision-making process rather than being required to do so by statute. We therefore proposed that the consultation requirements concerning designated land in section 121 be repealed.<sup>569</sup>

7.230 The majority of consultees agreed. Some noted that advertising rarely elicits any response, let alone any response that changes the trustees' decision. It was also criticised for being an additional administrative cost, indiscriminate, toothless, and "more honoured in the breach".<sup>570</sup> Conversely, some consultees strongly defended the requirement emphasising the importance of public consultation concerning community assets. We acknowledge those concerns, as well as the benefits of public consultation in some cases, but we remain of the view that a general statutory requirement to consult is unnecessary and burdensome for charities. As part of trustees' decision about

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<sup>569</sup> Consultation Paper, para 8.89.

<sup>570</sup> Stone King LLP.



whether and how to dispose of designated land (like any disposal of land) they should consider whether they should consult with the community or other interested people, but we do not think that should be a statutory requirement.

**Recommendation 18.**

7.231 We recommend that the requirements in section 121 of the Charities Act 2011 concerning advertising proposed disposals of designated land and considering any responses received should be abolished.

7.232 Clause 19 of the draft Bill would give effect to this recommendation.

**ACQUISITION OF LAND**

7.233 In the Consultation Paper, we asked whether the Part 7 advice requirements should be extended to the acquisition of land, since charities are just as much at risk of purchasing land at an overvalue as they are of selling land at an undervalue. Indeed, some consultees commented that the risks on acquisition were potentially more significant since acquiring land will often involve an ongoing liability to maintain the property. We pointed out that the Charity Commission already strongly recommends charities to follow the Part 7 regime when acquiring land. We asked consultees whether a flexible advice requirement, as we proposed (but have now ultimately rejected) for the disposal of land should apply to the acquisition of land.<sup>571</sup>

7.234 The majority of consultees said that if a flexible advice requirement was introduced for disposals of land, they supported the same being applied to acquisitions of land for consistency. Some, however, emphasised that they did not support the extension of the *existing* advice requirements in Part 7 to the acquisition of land, on the basis that they are too burdensome.

7.235 Some consultees commented that the existing prohibition (subject to obtaining appropriate advice) on dispositions could be enforced easily by the current practice of restrictions being entered on the register of title, whereas there is no similar practical means to enforce a prohibition (subject to dispensation following obtaining appropriate advice) on the acquisition of land by charities. That very practical consideration led them to conclude that advice requirements should not be imposed in respect of the acquisition of land. For example, Withers LLP said that, whilst it would be “simple ... to mirror the certification requirements ... so that they have to appear in the transaction documents”, in the absence of the restriction mechanisms, it would not be such a practical safeguard.

7.236 Despite the logic of extending the regime to acquisitions, the Charities’ Property Association doubted it was appropriate owing to the risks of charities’ offers being declined if the transaction will take longer; if a vendor wishes to sell land quickly and knows that a disposal to a charity will take longer, the vendor might instead choose to transact with an alternative buyer. In addition, they raised concerns about how advice could be obtained if property was being purchased at auction; the cost of commissioning

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<sup>571</sup> Consultation Paper, para 8.95.

a report in advance would be wasted if the charity was then outbid. Whilst a light-touch regime for acquisitions would not affect most members of the Charities' Property Association, "if a new regime were so light-touch that charity trustees generally could decide not to take external advice as a matter of course, would there be any point in having such a requirement at all?"

7.237 We agree with consultees' comments about the practicality of enforcing an advice requirement in respect of the acquisition of land in the absence of the restriction in the register as an enforcement mechanism. We also accept concerns about charities facing difficulties in bidding against other potential purchasers who are not subject to advice requirements.

7.238 We have recommended retention of the Part 7 regime for disposals, rejecting a new procedure for trustees to decide not to take advice, and we note the strong opposition of some consultees' to extending the *existing* Part 7 regime to acquisition. Those consultees would not, we think, be comforted by the other changes to Part 7 that we are recommending (expanding the category of designated advisers and simplifying the 1992 Regulations) were the regime to be extended to the acquisition of land.

7.239 We have concluded that the advice requirements in Part 7, even as amended in accordance with our recommendations above, should not be extended to the acquisition of land.

7.240 We acknowledge the inconsistency that is created by the current regime between acquisition and disposal of land. But merely extending the Part 7 regime to the acquisition of land would still leave inconsistencies in the law since land transactions would be treated differently from transactions involving other assets (such as intellectual property, shares, or artwork). And trustees remain subject to their general duties when acquiring land just as when deciding on any other transaction; the difference is simply that trustees' duties are enforced in a particular way by statute in the case of the disposal of land.

7.241 Some consultees criticised the Charity Commission's guidance<sup>572</sup> for its strong recommendation that charities should comply with Part 7 in the case of land acquisition since it is not always appropriate or necessary to do so. We think that the Charity Commission's guidance concerning acquisition should highlight considerations in the context of the acquisition of land that might make advice unnecessary. For example, the charity might have sufficient in-house expertise or it might deliberately purchase land in excess of market value in pursuit of its charitable purposes. In addition, the expansion of the category of designated advisers and simplification of the 1992 Regulations that we recommend above should equally apply to the Charity Commission's guidance on the acquisition of land.

7.242 The Charity Commission's guidance also recommends that trustees ensure that the RICS surveyor's report includes "a positive recommendation (with reasons) that it is in the interests of the charity to purchase the land".<sup>573</sup> In our view, it is very difficult for a RICS surveyor (or any designated adviser) to be expected to make such a

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<sup>572</sup> Charity Commission, *Acquiring Land* (CC33) (April 2001).

<sup>573</sup> Charity Commission, *Acquiring Land* (CC33) (April 2001), section 6.

recommendation, since decisions about what is in the interests of the charity are properly for the trustees. The equivalent requirement in Part 7 concerning the disposal of land is for the *trustees* to be satisfied that the terms of the disposition are the best that can reasonably be obtained for the charity.<sup>574</sup>

#### **Recommendation 19.**

7.243 We recommend that the Charity Commission amend its guidance *Acquiring Land* (CC33) as follows.

- (1) The guidance should reflect our recommendations to reform the regime governing the disposal of land, for example, suggesting that advice could be obtained from a fellow of the National Association of Estate Agents or fellow of the Central Association of Agricultural Valuers as well as a member of the Royal Institution of Chartered Surveyors.
- (2) The guidance should explain that trustees might decide not to obtain advice from those advisers, or from any advisers, with examples of when the trustees might make such a decision.
- (3) The suggestion that trustees seek advice on whether the proposed acquisition is in the interests of the charity should be removed.

## **EXISTING EXCEPTIONS TO THE ADVICE REQUIREMENTS IN PART 7**

### **Exempt charities**

7.244 Exempt charities are not required to comply with Part 7. In the Consultation Paper, we asked whether our proposed flexible advice requirement should apply to exempt charities.<sup>575</sup> Most consultees thought that the advice requirements should apply to exempt charities for the sake of consistency in the regulation of land transactions. Disagreement was based on a desire to avoid the duplication of regulation. Consultees pointed out that exempt charities are usually subject to tailored regulation which includes regulation of land transactions.

7.245 Land disposals by many exempt charities are indeed subject to regulation. Such land transactions are regulated by statute<sup>576</sup> and by contractual agreements between exempt charities and their principal regulator. Some exempt charities face prescriptive

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<sup>574</sup> Charities Act 2011, s 119(1)(c).

<sup>575</sup> Consultation Paper, para 8.91.

<sup>576</sup> An example of regulation by statute is the National Heritage Act 1983, s 2(5) which prohibits the Victoria and Albert Museum from disposing of land without the consent of the Secretary of State. An example of regulation by contractual agreements is the Higher Education Funding Council for England's ("HEFCE") financial memorandum with higher education institutions.

requirements similar to the existing Part 7 requirements;<sup>577</sup> others are subject to more flexible requirements.<sup>578</sup>

7.246 We do not wish to duplicate and confuse the regulation of exempt charities' land disposals by imposing the Part 7 advice requirements in addition to existing regulation. This is particularly the case now that we have rejected the introduction of a dispensation power. We do think, however, that there is some scope for harmonisation of the regulation of land transactions by exempt charities. As the Association for Church Accounts and Treasurers suggested, principal regulators could relax their own requirements in the knowledge that exempt charities were complying with the Part 7 regime. Similarly, Stone King LLP thought that some exempt charities might prefer our proposed duties to the existing regulation of their land transactions. We think that Part 7, as amended in accordance with our recommendations above, should provide a model on the basis of which principal regulators can set their regulatory requirements for exempt charities.

### Church of England land

7.247 The regime in Part 7 does not apply to certain dispositions of church land. Section 10(2) of the Charities Act 2011 excludes the following from the definition of "charity":

- (1) ecclesiastical corporations, in respect of corporate property of the corporation;<sup>579</sup>
- (2) a diocesan board of finance, in respect of diocesan glebe land;<sup>580</sup> and
- (3) "any trust of property for purposes for which the property has been consecrated".

7.248 Ecclesiastical law will apply to disposals of such land, rather than Part 7. Ecclesiastical law imposes restrictions which, in many ways, mirror those in Part 7.<sup>581</sup> It may be, therefore, that the Church of England will wish to consider amending the relevant

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<sup>577</sup> For example, in the case of the Victoria and Albert Museum (see n 576), the Secretary of State has set out the conditions on which consent will be granted: see [http://www.vam.ac.uk/\\_\\_data/assets/pdf\\_file/0003/243345/Funding-Agreement-2013-15-2015-16-Compressed.pdf](http://www.vam.ac.uk/__data/assets/pdf_file/0003/243345/Funding-Agreement-2013-15-2015-16-Compressed.pdf). The Museum's Funding Agreement requires it to follow the rules and guidance produced by HM Treasury; when disposing of land the museum must obtain professional advice including a RICS surveyor's valuation. See HM Treasury, *Managing Public Money* (July 2013) available at <https://www.gov.uk/government/publications/managing-public-money>.

<sup>578</sup> For example, HEFCE originally required compliance with obligations similar to those in Part 7, but now merely requires higher education institutions "to manage their estate in a sustainable way": see HEFCE, *Memorandum of assurance and accountability between HEFCE and institutions* (June 2014) available at [http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201412/HEFCE2014\\_12\\_.pdf](http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201412/HEFCE2014_12_.pdf).

<sup>579</sup> For example, the Church of England (Miscellaneous Provisions) Measure 2010, s 10(1), states that "the corporate body of a cathedral established under section 9(1)(a) of the Cathedrals Measure 1999 (1999 No. 1) is an ecclesiastical corporation for the purposes of section 10 of the Charities Act 2011."

<sup>580</sup> Diocesan glebe land is land vested under the Endowments and Glebe Measure 1976 in the diocesan board of finance. It is used for investment purposes to generate income for the Diocesan Stipend Fund: Endowments and Glebe Measure 1976, s 15.

<sup>581</sup> For example, the disposal of parsonage property requires consent from (a) the Church Commissioners, (b) the parsonages board, and (c) (if the power is being exercised by the incumbent) the bishop. However, the consent of the Church Commissioners will not be required if the disposition is not made to a "connected person", and the incumbent or bishop obtains and considers a written report on the disposition from a qualified surveyor: Parsonages Measures 1938, s 1. There are similar provisions in the New Parishes Measure 1943, s 17; and Endowments and Glebe Measure 1976, s 20.

ecclesiastical legislation to bring it into line with the amended regime in Part 7, for example, by expanding the category of designated advisers.

### **Sales by liquidators, administrators, receivers and mortgagees**

7.249 There is an existing exception from Part 7 in the case of “any disposition for which general or special authority is expressly given ... by any statutory provision contained in or having effect under an Act ...”.<sup>582</sup>

7.250 There is uncertainty as to whether the disposal of land by the liquidator or administrator of a charitable company would fall under this exception.<sup>583</sup> Similarly, there is uncertainty as to whether the sale of property by a receiver or mortgagee under their statutory powers of sale falls within the exception.<sup>584</sup> If such transactions fall within the Part 7 regime, various difficulties and uncertainties arise:

- (1) It is uncertain whether the administrator (or liquidator, receiver or mortgagee) is the “charity trustee” for the purposes of obtaining and considering a RICS surveyor’s report, and deciding to proceed with the transaction.
- (2) The surveyor must act “exclusively” for the charity. If administrators want to take advice to discharge their own duties, it is unclear whether they too can instruct the RICS surveyor or whether they must obtain (duplicate) advice from a different professional.
- (3) A recommendation for a lengthy marketing period might be incompatible with a proposed sale of the charity’s operations by an administrator.<sup>585</sup>

7.251 Whether or not such transactions fall within the section 117(3)(a) exception, there is still a requirement for the charity trustees to provide a Part 7 certificate. It is unclear whether administrators and liquidators are permitted to provide a certificate, and Val James’ experience was that administrators would have been very nervous if they were treated as the charity trustees for the purposes of the Charities Act 2011. But she said that requiring the charity trustees, who are no longer in control of the charity, to provide the certificate complicates an administration “to no real purpose”.

7.252 There is no policy reason why liquidators (including provisional liquidators), administrators, receivers and mortgagees should be required to comply with the advice requirements in Part 7. Their objective is to dispose of the charity’s operations, including its land, in order to obtain the best result for the creditor(s). For those purposes, they already have duties to ensure that they obtain a reasonable price (which might already result in them obtaining professional advice). But we do not think that they, or the charity trustees, should be required by statute to obtain such a report when land is being disposed of by an administrator, liquidator, receiver or mortgagee.

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<sup>582</sup> Charities Act 2011, s 117(3)(a); see para 7.13(1).

<sup>583</sup> The point was raised by Val James (solicitor). See, also, J Williams and P Dutton, “A charitable act: do the restrictions on the sale of charity land imposed by the Charities Act 2011 bind an administrator of a charitable corporation?” (2016) 1 *Corporate Rescue and Insolvency* 7.

<sup>584</sup> See J Williams and P Dutton, above.

<sup>585</sup> See J Williams and P Dutton, above.

## Disposals to other charities

7.253 A disposal to another charity is currently excluded from the Part 7 requirements under section 117(3)(c) if it is:

- (1) “otherwise than for the best price that can reasonably be obtained” (“the first limb”); and
- (2) “authorised to be so made by the trusts of the [transferor] charity” (“the second limb”).<sup>586</sup>

7.254 At first blush, the exception appears to be an example of a social investment within the meaning of section 292A of the Charities Act 2011: a charity enters into a transaction using its property (in this case the disposal of land) with a view to obtaining some financial return (albeit not the best price) and also to further its purposes.

7.255 We do not think that social investments ought to be automatically excluded from Part 7 by virtue of the section 117(3)(c) exemption. The decision to dispose of land as part of a social investment will very often require the trustees to have some idea of its market value in order to weigh up (broadly) whether the furtherance of the charity’s purposes justifies the disposal. Seeking such advice might in itself satisfy trustees’ additional duties, when making social investments, to “consider whether in all the circumstances any advice about the proposed social investment ought to be obtained”.<sup>587</sup>

7.256 During our discussions with the CLA and Charities’ Property Association, we therefore suggested repeal of the section 117(3)(c) exception (alongside the creation of the new procedure for dispensing with advice requirements which we have ultimately rejected). We received strong representations that the existing exception should remain because, in practice, it has a different scope and is not used for the type of social investments that its wording would suggest. Rather, we were told that the exception is meant for disposals – usually at nominal consideration – which are intended purely to further the transferor charity’s purposes, and not transactions which are intended to achieve any financial benefit for the transferor charity. It permits, in effect, a change of trustee; one charity is holding property for a particular charitable purpose, and it transfers the property to another charity to hold it for the same charitable purpose. We accept that such a transaction warrants different treatment; it is not a social investment, and being required to obtain advice under Part 7 would be unnecessary.

7.257 But the wording of the section 117(3)(c) exception is not limited to disposals which are motivated purely by the pursuit of the charity’s purposes. In our view, the words “otherwise than for the best price” in the first limb mean that the exception would apply if the trustees were obtaining (and motivated by) receiving a financial return of some sort from the transaction, and perhaps a financial return very close to the market value. The exception would, therefore, apply to the social investments that we discussed above.

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<sup>586</sup> See para 7.13(3).

<sup>587</sup> See Charities Act 2011, s 292C, inserted by the Charities (Protection and Social Investment) Act 2016, implementing our recommendations in *Social Investment by Charities: The Law Commission’s Recommendations* (September 2014).

7.258 In addition, the first limb raises the question of how a charity can know whether a disposition is “otherwise than for the best price” unless it has sought advice as to what the best price is. We think that the exception should turn instead on the intention of the trustees in making the disposition in question:

- (1) if it is in any way financially motivated (for example, a social investment), then the charity ought to seek advice as to the value of the property;
- (2) if it is not in any way financially motivated (as in the example set out in paragraph 7.256 above) then the charity ought not to be forced to seek advice.

7.259 Further, the second limb of the test – which, according to our discussions mentioned above, is intended to make clear that the disposal must be in pursuit of the transferor charity’s purposes – is either unnecessary or confusing. First, charities are only able to take action which is in pursuit of their purposes, so if that is all the second limb is intended to achieve, it is unnecessary. Alternatively, the second limb could be read as suggesting that some express authority is required, for example an express provision in the charity’s governing document. On that interpretation, the second limb is confusing and seems undesirable as a matter of policy. The CLA and Bircham Dyson Bell LLP thought this limb should be replaced with a requirement that the trustees “consider the disposal to be in furtherance of the purposes of the (disposing) charity”. However, for the reasons given, we do not think that this limb serves any useful or desirable purpose and should therefore be removed.

7.260 In summary, in so far as section 117(3)(c) can currently be used to exclude social investments from the Part 7 advice requirements, we do not think that it should. But nor do we think that disposals which are intended purely to further the transferor’s purposes should be covered by the Part 7 advice requirements. We have therefore concluded that the section 117(3)(c) exception should be reformulated (1) to make clear that it does not apply to social investments (within the meaning of section 292A); (2) to make clear that it does apply to disposals which are purely intended to further the transferor charity’s purposes; and (3) to address the other uncertainties discussed above.

### **Leases to beneficiaries**

7.261 There is an existing exception from the Part 7 advice requirements in section 117(3)(d) for leases to beneficiaries of a charity “granted otherwise than for the best rent that can reasonably be obtained” and intended to enable the premises to be occupied for the charity’s purposes.<sup>588</sup>

7.262 Such a transaction is likely to amount to a social investment, being a transaction using a charity’s property that is motivated by the pursuit of the charity’s purposes and by the financial return.<sup>589</sup> For the reasons given above, we think that advice on the market rent from a property would often be a relevant consideration for a charity that is granting a lease to a beneficiary and trustees would need to consider whether to obtain such advice in accordance with their duties under section 292C of the Charities Act 2011. However, unlike the exception in section 117(3)(c), consultees made no comments or criticisms regarding this provision or its application in practice. We believe that this

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<sup>588</sup> Charities Act 2011, s 117(3)(d). See para 7.13(4) above.

<sup>589</sup> Charities Act 2011, s 292A.

exception only applies in a small number of cases; to very specific charities; and in situations where the risk of depletion of charity assets is low. We therefore think that to repeal the exception and force the few charities who rely on it to comply with Part 7 would be to increase the burden of regulation unnecessarily and without support from consultees.

#### **Recommendation 20.**

7.263 We recommend that:

- (1) disposals of land by liquidators, provisional liquidators, administrators, receivers and mortgagees be excluded from Part 7 of the Charities Act 2011; and
- (2) the exception in section 117(3)(c) of the Charities Act 2011 be reformulated such that it applies only to disposals that are solely intended to further the transferor charity's purposes.

7.264 Clause 18(2)(a), (2)(c) and (3)(a) of the draft Bill would give effect to this recommendation.

#### **THE UNIVERSITIES AND COLLEGE ESTATES ACTS**

7.265 The regime in Part 7 of the Charities Act 2011 does not apply to dispositions and mortgages "for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925".<sup>590</sup> We refer to this as "the UCEA exception".

#### **Historical background to the Universities and College Estates Acts 1925 and 1964**

7.266 The Universities and College Estates Act 1925 ("the UCEA 1925") applies to:

- (1) the Universities of Oxford, Cambridge and Durham ("the universities");
- (2) the colleges and halls of Oxford, Cambridge and Durham ("the colleges");
- (3) Winchester College ("Winchester"); and
- (4) Eton College ("Eton").<sup>591</sup>

We refer to these bodies as "the UCEA institutions".

7.267 The UCEA 1925 was a power-conferring Act.<sup>592</sup> A series of "disabling statutes" had prevented the colleges (but not the universities), Winchester and Eton from disposing

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<sup>590</sup> Charities Act 2011, ss 117(3)(b) and 124(9)(b). See para 7.13(2) and 7.14(2) above.

<sup>591</sup> UCEA 1925, s 1. The universities are exempt charities, but the colleges are not: Charities Act 2011, Sch 3, paras 2 and 4(2). Following the Charities Act 2006, Winchester and Eton ceased to be exempt charities.

<sup>592</sup> It consolidated the Universities and College Estates Acts 1858 to 1898. For a historical summary, see *Hansard* (HC) 13 March 1964, vol 691, cols 939 to 949.



of land.<sup>593</sup> The UCEA 1925 conferred on the UCEA institutions numerous powers to deal with land subject to conditions and, in respect of some powers, subject to the Minister's consent ("the Listed Powers").<sup>594</sup> Section 21 conferred a general power to enter into any other unlisted transaction provided that the UCEA institution concerned obtained the Minister's consent ("the General Power").

7.268 The Universities and College Estates Act 1964 ("the UCEA 1964"):

- (1) repealed the "disabling statutes", but only in respect of the colleges;
- (2) removed the requirement for Ministerial consent to the exercise of the Listed Powers, but only in respect of the colleges and universities;
- (3) left unchanged the need for Ministerial consent to the exercise of the General Power; and
- (4) left the UCEA 1925 unchanged in respect of Winchester and Eton.

The universities and colleges

7.269 Although the matter is not free from doubt, it seems that the UCEA 1925 supplemented the existing powers of the universities and colleges.<sup>595</sup> Following the repeal of the disabling statutes by the UCEA 1964, the colleges could exercise the UCEA 1925 powers or the powers in their governing documents. And the universities were never subject to the disabling statutes, so could always exercise the UCEA 1925 powers or the powers in their governing documents.

7.270 The universities and colleges, therefore, only need the Minister's consent to a disposal of land if they need to rely on the General Power. If they have the necessary power in their governing documents, or if the transaction falls within the Listed Powers, they do not need Ministerial consent, and the UCEA exception will not apply.<sup>596</sup>

Winchester and Eton

7.271 As with the universities and colleges, it seems that the UCEA 1925 supplemented any existing powers of Winchester and Eton. Whilst the UCEA 1964 did not repeal the disabling statutes as far as the Winchester and Eton were concerned, the Statute Law (Repeals) Act 1998 did.<sup>597</sup> Winchester and Eton can therefore now rely on the UCEA 1925 powers and the powers in their governing documents.<sup>598</sup> The exercise of some of

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<sup>593</sup> The Ecclesiastical Leases Acts 1571, 1572, 1575 and 1836.

<sup>594</sup> Powers had also been conferred on Eton by a scheme made in 1904 which overrode the disabling statutes: *Eton College v Minister of Agriculture, Fisheries and Food* [1964] 1 Ch 274.

<sup>595</sup> UCEA 1925, ss 25(2) and 42.

<sup>596</sup> The universities would still not be required to comply with the Part 7 requirements because they are exempt; the colleges are not exempt, but other exceptions may apply (see n 421 above and n 600 below).

<sup>597</sup> Implementing our recommendations in Statute Law Repeals 16th Report (1998) Law Com 252.

<sup>598</sup> As noted in n 594 above, Eton enjoyed certain powers under a scheme made in 1904. Eton has also told us that its statutes were amended under the Public Schools Act 1868 to include supplemental powers. Winchester, by contrast, has told us that its powers are limited to those under the UCEA 1925.

the Listed Powers under the UCEA 1925 remains subject to Ministerial consent, since the UCEA 1964 did not remove that requirement for Winchester and Eton.

7.272 Winchester and Eton, therefore, only need the Minister's consent to a disposal of land if they need to rely on the General Power or certain Listed Powers. If they have the necessary power in their governing documents, or if the Listed Power does not require the Minister's consent, they do not need Ministerial consent, and the UCEA exception will not apply.<sup>599</sup>

### **Application of Part 7 of the Charities Act 2011**

7.273 Part 7 does not apply if a transaction must be authorised by the Minister under the UCEA 1925. As far as the universities and colleges are concerned, therefore, all other things being equal, the requirements in Part 7 would not apply if (and only if) they were using the General Power (which requires the Minister's consent).<sup>600</sup> As far as Winchester and Eton are concerned, the requirements in Part 7 would not apply if they were using the General Power or certain Listed Powers (which require the Minister's consent).<sup>601</sup>

### **The Consultation Paper**

7.274 The UCEA 1925 sets out certain matters that the Minister must consider when deciding whether to give consent. In the Consultation Paper, we said that trustees should be under the same obligation to obtain advice whether or not they are obtaining Ministerial consent to the disposition and we proposed that the UCEA exception be repealed so that that the Part 7 advice requirements apply even if the transaction must be authorised by the Minister under the UCEA 1925.<sup>602</sup>

7.275 We also asked a more general question about the UCEA 1925. The Act is long and complicated. We questioned whether the UCEA 1925 was helpful to the institutions to which it applied. When they need to rely on the UCEA 1925 powers (rather than on their governing document), they must sometimes obtain Ministerial consent to enter into transactions that other charities can enter without restriction. Many charities will enjoy the benefit of the default powers conferred by the Trusts of Land and Appointment of Trustees Act 1996 and by the Trustee Act 2000, but those powers appear not to apply to the universities, the colleges, Winchester and Eton.<sup>603</sup> We asked consultees whether

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<sup>599</sup> Until the Charities Act 2006, Winchester and Eton would not have had to comply with Part 7 in any event by reason of being exempt charities, but their exempt status was removed by the Charities Act 2006, s 11(3). We have been told by Eton that transactions it enters into using powers conferred under the Public Schools Act 1868 are exempt under Charities Act 2011, s 117(3)(a) (see para 7.13(1) above).

<sup>600</sup> Even then, if they were exercising other powers, Part 7 might not apply by reason of other exceptions. The universities are exempt charities so do not need to comply in any event. Moreover, the Cambridge Colleges have suggested that the UCEA exception is redundant since, if a transaction is made using any power in the UCEA 1925, then the exception in s 117(3)(a)(i) will apply; see n 421 above.

<sup>601</sup> Again, if they were exercising other powers, other exceptions from Part 7 might nevertheless apply; see n 599.

<sup>602</sup> Consultation Paper, paras 8.122 and 8.123.

<sup>603</sup> Section 1(3) of the Trusts of Land and Appointment of Trustees Act 1996 and s 10(1)(b) of the Trustee Act 2000 provide that the default powers do not apply to land (or a trust) "to which [the UCEA 1925] applies". This wording is ambiguous, since the UCEA 1925 applies to named institutions, rather than their "land" or "trusts". Nevertheless, these provisions would appear to be intended to exclude the named institutions from the default powers.

the UCEA 1925 should be repealed and replaced by general powers which are not subject to Ministerial consent.<sup>604</sup>

### Consultation responses

7.276 Some consultees did not agree that the Part 7 advice requirements should apply if the Minister's consent was required to exercise a power under the UCEA 1925 since that would involve double regulation. The considerations of the Minister under the UCEA should ensure that a fair price is obtained<sup>605</sup> and there is no need to overlay the Charities Act 2011 advice requirements which are intended to achieve the same thing. We accept those comments.

7.277 Consultees were also cautiously optimistic about replacing the UCEA 1925 with general powers in order to avoid the complexity of the provisions in the Act and also to remove the requirement for Ministerial consent to land transactions (where the charities concerned seek to rely on a UCEA power that requires Ministerial consent, rather than on other UCEA powers or powers in their governing documents).

7.278 Our discussions with the officials from the Department for Environment, Food and Rural Affairs ("Defra") who administer the Minister's consent function under the UCEA 1925 have confirmed that there is no longer a policy need for Defra to provide the UCEA institutions with consent to land transactions under the UCEA 1925. Other colleges and universities are not subject to such restrictions. Furthermore, there is a risk for Defra that giving consent to a particular transaction could be viewed as granting planning permission or consenting to a development when that decision lays elsewhere. Defra indicated agreement with replacing the UCEA 1925 with general powers for the institutions concerned, or with an amendment to the UCEA 1925 under which the requirement for Ministerial consent (where it exists) is removed.

### Discussion

7.279 In our view, the UCEA 1925 is a complicated Act and those who rely on it would benefit from a consolidated general statutory power in respect of land transactions, similar to the general power in the Trusts of Land and Appointment of Trustees Act 1996. Moreover, we do not think that the requirement to obtain the Minister's consent (where it applies) is appropriate since Defra does not have the relevant policy interest concerning land transactions by charities and it is anomalous that a Minister should have special functions in respect of a handful of particular institutions. We therefore recommend that the many complicated provisions of the UCEA 1925 be replaced with a general power for the charities concerned to enter into any land transaction.

7.280 That leaves the question of whether charities using the new replacement power should be required to comply with the Part 7 advice requirements. At present, the universities are exempt in any event, and the colleges (as we understand it) say that Part 7 does not apply to transactions undertaken pursuant to the UCEA 1925 (whether with or without Ministerial consent) since such transactions are authorised by a statutory

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<sup>604</sup> Consultation Paper, para 8.125.

<sup>605</sup> Although rather obscurely the UCEA 1925 requires the Minister to be satisfied that the land transaction is for the benefit of "land belonging to the college or university" rather than for the benefit of the "charity". This makes the test difficult to assess as it is hard to say how a land transaction is of benefit or detriment specifically to the land belonging to an institution as opposed to how the transaction benefits the institution more generally.

provision and so are excluded by section 117(3)(a). We further understand that the Oxford and Cambridge colleges say that Part 7 does not apply to transactions made using powers in their governing documents (their “statutes”), since the statutes were made under the Universities of Oxford and Cambridge Act 1923 and therefore fall within the same section 117(3)(a) exception as dispositions for which general or special authority is expressly given by a statutory provision.<sup>606</sup> At present, therefore, the only oversight of land transactions by the UCEA institutions arises where the institution relies on a UCEA power for which the Minister’s consent is required and that oversight is by means of the conditions in the UCEA and not by means of the Charities Act 2011.

7.281 Our view is that the Part 7 requirements should apply when the UCEA institutions exercise the replacement general power, since the conditions currently incorporated into the UCEA 1925 governing the exercise of those powers (and therefore providing some safeguard of charitable assets) would not be replicated. The alternative would be to permit the UCEA institutions to rely on the replacement general power, but not to require compliance with the Part 7 advice requirements, but we do not see a principled basis for that approach. The origin of the power being used by a charity – whether the new UCEA power or the general powers under the Trusts of Land and Appointment of Trustees Act 1996 – is irrelevant to the objective of Part 7, namely the protection of charitable assets.

7.282 Having discussed this issue further with the UCEA institutions, we have concluded that the UCEA exception from Part 7 should be repealed. In reality, we suspect that the colleges will not wish to comply with the Part 7 requirements and will therefore more commonly exercise the powers in their statutes, relying on the argument set out above, namely that the exercise of such powers falls within the section 117(3)(a) exception on the basis that their statutes are made under the authority of an Act of Parliament.

**Recommendation 21.**

7.283 We recommend that:

- (1) the detailed provisions in the Universities and College Estates Act 1925 be repealed and the institutions to which it applies be given the general powers of an owner similarly to trustees under the Trusts of Land and Appointment of Trustees Act 1996 and the Trustee Act 2000; and
- (2) the exercise of that replacement power should not, of itself, engage the exception from the Part 7 advice requirements in section 117(3)(a) of the Charities Act 2011.

7.284 Clause 26 of the draft Bill would give effect to this recommendation. Clause 18(2)(b) and (3)(b) also repeals the UCEA exception.

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<sup>606</sup> See n 421 above. A similar argument could be made by the Durham colleges in respect of any statutes made under the Universities of Durham and Newcastle upon Tyne Act 1963.

# Chapter 8: Permanent endowment

## INTRODUCTION

8.1 This chapter considers the law relating to the use of permanent endowment. Broadly speaking, permanent endowment is property belonging to a charity that cannot be spent and falls into the following two categories.

- (1) It can be a fund of assets, such as shares, that produce an income to fund the charity's activities. The charity can sell an investment in the fund to purchase another, but it cannot sell an investment and spend the proceeds to further its purposes. This is known as "investment permanent endowment".
- (2) It can be property that does not produce an income but is used by the charity to pursue its purposes, for example a village hall or a recreational ground. The charity might be able to sell the property and purchase other property that performs the same function,<sup>607</sup> but it cannot spend the proceeds of any sale on its day-to-day activities. This is known as "functional permanent endowment".

8.2 The focus of this chapter is on investment permanent endowment.

8.3 In Chapter 9 of the Consultation Paper we examined the law relating to the use of permanent endowment, in particular the law regulating the release of the restrictions on its being spent. Our review was precipitated by our work on social investment by charities.<sup>608</sup> Several of those who responded to the consultation on social investment expressed dissatisfaction with the current procedures for releasing the restrictions on spending permanent endowment. They complained that the current law inhibits the use of permanent endowment funds to make social investments with an expected negative financial return<sup>609</sup> but which were nevertheless in the interests of the charity because of the expected benefit they would deliver to the charity's mission.

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<sup>607</sup> This will depend on whether specific property must be retained in order for the charity to pursue its purposes: see *Oldham Borough Council v Attorney General* [1993] Ch 210; *Trustees of the Bath Recreation Ground Trust v Sparrow* [2015] UKUT 420 (TCC). The CLA distinguished between (1) inalienable permanent endowment, which is unique property, disposal of which would defeat the purposes of the charity such that a sale would require a *cy-près* scheme (for example, an historic building or artefact), and (2) alienable permanent endowment, which can be sold and replaced with similar assets to be used for the same purposes (for example, playing fields).

<sup>608</sup> *Social Investment by Charities: The Law Commission's Recommendations* (September 2014) ("Social Investment Report"); *Social Investment by Charities* (2014) Law Commission Consultation Paper No 216 ("Social Investment Consultation Paper"). See Fig 13 for the definition of "social investment".

<sup>609</sup> We distinguish between a "positive financial return" and "negative financial return": see Fig 13 and *Social Investment Consultation Paper*, para 1.13. Mainstream financial investments, and many social investments, are expected to yield a positive financial return, namely the return of the initial capital outlay together with an income return or capital appreciation or both. Some social investments, however, are expected to yield a negative financial return, which involves the return of only part of the initial capital outlay so the charity receives back less from a transaction – in financial terms – than it put in. The definition of "financial return" in section 292A(5) of the *Charities Act 2011* (inserted by s 15 of the *Charities (Protection and Social Investment) Act 2016*) includes both a positive and negative financial return.

- 8.4 We made a number of provisional proposals to change aspects of the regime governing the release of permanent endowment restrictions, which were largely supported by consultees. We make recommendations below for the expansion and rationalisation of the existing regime.
- 8.5 We also asked consultees whether there should be a new regime, which we suggested be called “preserved endowment”, whereby trustees would be free to spend the capital of the endowment fund subject to a duty to seek to maintain the real value of the fund in the long term. This was met with caution in consultation. We do not recommend that a new regime be created. Instead, we make two more limited recommendations that would permit charities, first, to borrow from permanent endowment, and second, to use permanent endowment to make social investments with a negative financial return within the existing framework for total return investment.
- 8.6 This chapter deals with complex law and we use various technical terms throughout. Figure 13 gathers together and explains the meaning of those terms.

### Figure 13: terminology in this chapter

*Permanent endowment:* property that is held by, or on behalf of, a charity subject to a restriction on being spent;<sup>610</sup> see paragraphs 8.7 to 8.25. The default position is that the trustees cannot spend the capital.

*Expendable endowment:* property which is subject to a restriction on being spent, unless and until the trustees decide to do so; the trustees have a discretion to spend the capital.

*Special trust:* a fund that is held subject to a requirement that it be used for particular purposes within the wider purposes of the charity.<sup>611</sup>

*Spending permanent endowment:* using permanent endowment in a way that is inconsistent with the restriction on expenditure; see paragraphs 8.35 to 8.37.

*Converting permanent endowment:* selling permanent endowment and using the proceeds to purchase replacement property to be used in the same way.<sup>612</sup>

*Total return investment (“TRI”):* investing assets with a view to optimising the overall investment return, no matter whether that takes the form of capital or income; see paragraphs 8.50 to 8.54, 8.117 (and figure 18) and 8.121.

*Social investment:* a transaction that is entered into with a view to both (a) directly furthering the charity’s purposes, and (b) achieving a financial return for the charity. The term is defined in section 292A of the Charities Act 2011. A social investment can have a positive or negative financial return.<sup>613</sup>

*Portfolio offsetting:* using investment permanent endowment to make social investments that are expected to lose money (that is, pay back less than the initial outlay) in circumstances where the trustees expect to offset any losses by gains elsewhere in the portfolio; see paragraphs 8.57, 8.116 to 8.117, and 8.137 to 8.141.

*Positive financial return:* a return that is greater than the amount initially invested, for example, investing £100 in shares and at the end of the year those shares are worth £105 and/or have yielded an income of £5.

*Negative financial return:* a return that is less than the amount initially invested, for example, using £100 to purchase an asset which, at the end of the year, is worth £90. This term is used in the context of social investment by charities; the charity is promoting a charitable purpose through investment as well as seeking a financial return (which might be a positive or a negative financial return).

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<sup>610</sup> Section 353(3) of the Charities Act 2011 provides “A charity is to be treated for the purposes of this Act as having a permanent endowment unless all property held for the purposes of the charity may be expended for those purposes without distinction between (a) capital, and (b) income; and in this Act “permanent endowment” means, in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity”.

## WHAT IS PERMANENT ENDOWMENT?

8.7 Consultation revealed that “permanent endowment” can mean different things to different people. The term is not always used to mean “permanent endowment” as defined by statute. As we explain in paragraph 8.11 below, some consultees thought that permanent endowment had universal characteristics, but whether that is true depends on what they mean by “permanent endowment”. Some consultees thought that there ought to be clear rules setting out how permanent endowment can be used, but again that depends on what they mean by “permanent endowment”. We consider these assumptions in more detail below, alongside the effect that they had on consultees’ responses, and their relevance to the application of the current law and our recommendations for reform.

### Statutory definition

8.8 The statutory definition of permanent endowment was first introduced in the Charities Act 1960<sup>614</sup> and now appears in section 353(3) of the Charities Act 2011:

A charity is to be treated for the purposes of this Act as having a permanent endowment unless all property held for the purposes of the charity may be expended for those purposes without distinction between—

- (a) capital, and
- (b) income;

and in this Act “permanent endowment” means, in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity.

8.9 The distinction between functional and investment permanent endowment (set out in paragraph 8.1 above) does not appear in the statutory definition.

8.10 Whether property is permanent endowment is a matter of interpretation of the governing document and, where relevant, other documents such as conveyances, wills and

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<sup>611</sup> The definition in s 287(1) of the Charities Act 2011 is “property which (a) is held and administered by or on behalf of a charity for any special purposes of the charity, and (b) is so held and administered on separate trusts relating only to that property”. The “special purposes” of a charity are purposes within, but narrower than, the purposes generally for which the charity is established, such as funds raised as a result of an appeal for a particular purpose.

<sup>612</sup> Investment permanent endowment can be converted; in a portfolio, assets can be sold and the proceeds used to purchase replacement assets. As for functional permanent endowment, to use the CLA’s terminology in n 607 above, alienable permanent endowment (such as playing fields) can be converted, but inalienable permanent endowment (such as an historic building) cannot.

<sup>613</sup> See definitions below and n 609 above.

<sup>614</sup> Charities Act 1960, s 45(3). Before then, the Charitable Trusts Act 1853, s 66, defined “endowment”. In *Re Clergy Orphan Corporation* [1894] 3 Ch 145, at 151, the Court of Appeal recognised that a charity could have endowment that was not freely expendable on its purposes, but gave no special name to such property. See also *Re Gilchrist Educational Trust* [1895] 1 Ch 367.



historical evidence of how property has been used.<sup>615</sup> We set out some examples of permanent endowment in Figure 14.

#### **Figure 14: examples of permanent endowment**

In its operational guidance the Charity Commission gives several examples of what may be found in a charity's governing document or other instrument to indicate that property is permanent endowment.<sup>616</sup>

The following are examples of property that is likely to be permanent endowment:

- (1) land and buildings held for a specific charitable purpose with no power for them to be sold;
- (2) money donated on the condition that it is to be invested and the income received from the investment is to be spent on the purposes of the charity;
- (3) property that is to be held "forever" or "in perpetuity"; and
- (4) surplus income that is set aside by the trustees pursuant to a power of accumulation and invested to increase the income of the charity.

The following are examples of property that is unlikely to be permanent endowment:

- (1) money to be spent by the trustees in furtherance of the purposes of the charity in such manner as they see fit; and
- (2) money donated to be invested but which can be spent if the trustees so decide.

#### **The nature of permanent endowment**

8.11 Consultation revealed various assumptions and uncertainties about permanent endowment.

- (1) It is widely believed that, when a company or CIO holds permanent endowment, it is always held on trust.
- (2) It is widely believed that, when a company or CIO holds permanent endowment (and, it follows from (1) that it does so as trustee), the permanent endowment is a distinct charity.<sup>617</sup>
- (3) Consultees reported uncertainty as to whether permanent endowment can be mortgaged by a charity.

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<sup>615</sup> Charity Commission, *OG545-1 Identifying and Spending Permanent Endowment* (May 2015), para E1.1, hereafter "OG545-1", available at <http://ogs.charitycommission.gov.uk/g545a001.aspx>.

<sup>616</sup> OG545-1, para D1.

<sup>617</sup> See also para 12.34 and Fig 21 below.

- (4) Consultees reported uncertainty as to whether charities can “self-endow” (that is, create permanent endowment from their unrestricted funds).
- 8.12 There is no direct authority on these points. Underlying them is an assumption that, if property is “permanent endowment”, then certain features must always exist. It is assumed that, *because* property is permanent endowment, (1) it is held on trust, (2) it is a distinct charity, (3) there ought to be a clear rule that it can (or cannot) be mortgaged, and (4) there ought to be a clear rule that it can (or cannot) be created by a charity.
- 8.13 In fact, the only universal feature of permanent endowment (as defined in statute) is that it is subject to some sort of restriction on being spent. “Permanent endowment” is simply a label for a range of possible restrictions that might apply.<sup>618</sup>
- 8.14 Put another way, it is not because property is labelled “permanent endowment” that it is subject to a particular restriction on being spent; rather, it is because there is a restriction on spending that the property is labelled “permanent endowment”.
- 8.15 The term “permanent endowment” is used for five purposes under the Charities Act 2011:<sup>619</sup>
- (1) charities can resolve to invest their permanent endowment on a total return basis;<sup>620</sup>
  - (2) unincorporated charities have a power to transfer their assets to another charity and special provision is made for permanent endowment;<sup>621</sup>
  - (3) unincorporated charities have a power to release permanent endowment from the restrictions on its being spent;<sup>622</sup>
  - (4) the statutory power to make social investments can only be used in respect of permanent endowment in so far as the transaction is consistent with the permanent endowment restriction;<sup>623</sup> and

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<sup>618</sup> A permanent endowment restriction will often impose a complete prohibiting on spending the capital, but it need not do so. The statutory definition would include a restriction on spending the capital on particular transactions or for a certain period of time.

<sup>619</sup> The definition is stated to be “for the purposes of this Act”: Charities Act 2011, s 353(3). The definition was first introduced in the Charities Act 1960. As the CLA pointed out, under that Act, charities with a low income and no “permanent endowment” were not required to register, so the definition played a role in determining whether a charity had to be registered. It appears that, if there was any doubt, the presumption was that the charity had permanent endowment to ensure that it was registered.

<sup>620</sup> Charities Act 2011, ss 104A and 104B. See, further, paras 8.50 to 8.54.

<sup>621</sup> Charities Act 2011, ss 267 to 274. See Ch 11.

<sup>622</sup> Charities Act 2011, ss 281 to 292. See, further, paras 8.40 to 8.49.

<sup>623</sup> Charities Act 2011, s 292B(2).

- (5) special provision is made for permanent endowment in the case of registered charity mergers.<sup>624</sup>

Aside from these provisions, statute does not make general provision about what can, and cannot, be done with permanent endowment.

- 8.16 The mere fact that property falls within the statutory definition of permanent endowment – and therefore that these statutory provisions apply – does not, itself, lead to the propositions (or answer the questions) in paragraph 8.11 above. Our conclusion is that it is neither necessary, nor possible, to provide universal and comprehensive answers to those points. The answers will, in our view, always depend on the terms of the restriction itself. It may be possible to identify the most common answer, but it is not possible to be definitive for all cases.

Is permanent endowment always held on trust?

- 8.17 In the Consultation Paper, we suggested that permanent endowment is always held on trust.<sup>625</sup> In the light of our analysis above – that the correct approach is to ask (1) what is the restriction on this property and then (2) does that restriction fall within the statutory definition of permanent endowment – our view has changed. The fact that property falls within the statutory definition of permanent endowment will not necessarily mean that the property is always held on trust. In order to determine whether property is held on trust it is necessary to look at the terms of the instrument giving rise to the endowment and the manner in which it is managed. Nonetheless, the existence of a restriction on spending the property (making it permanent endowment for the purposes of the statutory definition) is often a circumstance from which to infer the existence of a trust.
- 8.18 A company might own property that is subject to a restriction on expenditure that appears in its articles of association, such that the property falls within the statutory definition of permanent endowment, without the property being subject to a trust. It has been suggested to us that the fact a company can be dissolved (or that its articles can be amended) means that it cannot hold permanent endowment beneficially. We do not agree that that necessarily follows from the statutory definition of permanent endowment; the prospect of dissolution (or a change to the company's articles) at a future date does not prevent property that is beneficially owned by a company from being subject to a restriction on being spent. As William Henderson (a barrister) pointed out, the statutory definition does not state that the restriction must be “an irremovable restriction”.
- 8.19 It has also been suggested to us, in reliance on *Re Faraker* and subsequent case law,<sup>626</sup> that a permanently endowed charity can never disappear, even if subject to a scheme, so a company cannot own permanent endowment beneficially. That case law concerned the concept of “perpetual” or “endowed” charities, not the statutory definition

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<sup>624</sup> Charities Act 2011, ss 305 and following. See Ch 11.

<sup>625</sup> Consultation Paper, paras 13.22 to 13.28, and 9.19.

<sup>626</sup> *Re Faraker* [1912] 2 Ch 488 and subsequent cases (*Re Lucas* [1948] Ch 424; *Re Bagshaw* [1954] 1 WLR 238; *Re Roberts* [1963] 1 WLR 406; *Re Stimson* [1970] Ch 16; *Re Vernon* [1972] Ch 300; and *Re Finger* [1972] Ch 286).

of permanent endowment.<sup>627</sup> The cases established that such a charity cannot disappear, for the purposes of ensuring that certain gifts by will did not fail. The idea that these charities cannot disappear did not concern the particular mechanism through which the charity's purposes were pursued (for example, a trust or a company) but rather concerned an abstract concept of a "charity" continuing, for the purpose of collecting legacies in wills. So whilst a "perpetual" or "endowed" charity might never disappear (and so will effectively collect charitable gifts by will that might otherwise have failed), it does not follow that property within the statutory definition of permanent endowment can never disappear and must therefore always be held on trust.

Is permanent endowment a distinct charity?

- 8.20 Where permanent endowment is held by human trustees it will usually be a separate trust (since the terms of the trust will impose some sort of spending restriction that applies to the property in question). However, there is no reason why the permanent endowment should be treated as a separate charity. Similarly, where permanent endowment is held by a corporate trustee (that is, it is held on trust by a corporate body), it will be a stand-alone trust (and the corporation's unrestricted property will be owned beneficially). Again there is no reason in principle why the permanent endowment should be treated as a separate charity, but that is the long-standing belief and practice of the Charity Commission and the charity sector. The result is that, when a trust wishes to incorporate, the unrestricted assets will be transferred to the company and the company will be appointed trustee of the permanent endowment assets (which will continue to be held on trust). The company and the permanent endowment will then be treated by the Charity Commission as two different charities.
- 8.21 This "separate charities" analysis creates an anomaly under the provisions providing for the release of permanent endowment since the gateways to those powers refer to the income of "the charity". Whether "the charity" is the permanent endowment itself or the charity holding it will depend on how the fund is held. This anomaly is explored further in paragraphs 8.70 to 8.73 below.

Conclusion

- 8.22 Beyond demarcating the availability of the Charities Act 2011 powers in paragraph 8.15 above, it is unhelpful to assert that permanent endowment can, or cannot, always be used in a particular way. Rather, the relevant question in any particular case is whether *this specific* property, which is subject to *this specific* restriction, can be used in a particular way.
- 8.23 Suggestions by consultees that statute should provide the answers to the questions identified in paragraph 8.11(3) and (4) above, or that permanent endowment always has particular characteristics (such as those in paragraph 8.11(1) and (2) above), overestimate the purpose and scope of the statutory definition of permanent endowment. The permitted use of property cannot, and should not, be codified by reference to its statutory label in the Charities Act 2011; rather, it is regulated by trust and company law applicable to the property in question.

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<sup>627</sup> Indeed, three of the cases pre-date the first statutory definition of permanent endowment.

8.24 Nor do we agree with the suggestion that a wide statutory definition of permanent endowment is necessarily problematic.<sup>628</sup> As the permanent endowment label is the gateway into the powers identified in paragraph 8.15(1) to (3) above, it is helpful for the statutory definition to be broad because it ensures that those powers have a wide application. It is only if one tries to make the statutory definition do more than it is meant to do (such as provide universal answers to the points in paragraph 8.11 above) that difficulties would arise from its broad scope.

8.25 We have drawn the following conclusions.

- (1) The phrase “permanent endowment” means different things to different people.
- (2) There is a dearth of authority on the statutory definition of “permanent endowment”.
- (3) The only universal characteristic of “permanent endowment”, as defined in statute, is that there is some sort of restriction on spending the capital.
- (4) The purpose of the statutory definition of permanent endowment is to demarcate the availability of some facilitative powers under the Charities Act 2011, and, in the case of transfers of assets to another charity, to provide a tailored regime for the treatment of permanent endowment, but nothing more.
- (5) The assertions that “permanent endowment is always held on trust” and that “a company cannot hold permanent endowment beneficially” do not reflect the statutory definition but rather involve a different concept of “permanent endowment” as property that must be held in perpetuity or as a separate identifiable entity that will always exist.
- (6) Nevertheless, property that falls within the statutory definition will very often be held on trust as a matter of trust law; it may be established explicitly as a trust,<sup>629</sup> or it might simply be the best interpretation of an ambiguous gift. But, crucially, if property is held on trust, that is not by reason of the fact that it falls within the statutory definition of permanent endowment.

### **Effect on the current law and on our recommendations**

8.26 The assumptions in paragraph 8.11(1) and (2) above pervaded consultees’ responses and are relevant to the operation of the current law in three ways.

- (1) Various powers are available to a “charity” with an income below a certain threshold.<sup>630</sup> If (as consultees assumed) permanent endowment is a separate

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<sup>628</sup> Some consultees complained that s 353(3) introduced a “presumption” that a charity holds permanent endowment, unless they can show that all of their assets are freely expendable.

<sup>629</sup> In many cases, the existence of a trust will be clear. For example, when a charitable trust wishes to incorporate, the incorporation will usually be structured in such a way that any permanent endowment continues to be held on trust with the new charitable company becoming the trustee of that trust. We are not suggesting that on incorporation permanent endowment should be transferred to, and owned beneficially by, the new charitable company subject to a restriction set out in the company’s articles.

<sup>630</sup> For example, Charities Act 2011, s 275 permits a charity to change its purposes in certain circumstances (see Ch 4) and s 268 permits a charity to transfer its property to another charity (see Ch 11).

charity, these powers can be used in respect of the permanent endowment, and the financial limits apply only to the permanent endowment (and not the charity as a whole).

- (2) The power to release permanent endowment restrictions in sections 281 and 282 apply to a charity “which is not a company or other body corporate”.<sup>631</sup> However, if (as consultees assume) permanent endowment is always held on trust and is a separate charity, then the power is available even though the holding charity is a company or other body corporate.
- (3) Certain assumptions are made about the availability of permanent endowment to creditors on insolvency; as we discuss in Chapter 12, the availability of charity property to creditors on insolvency depends on whether or not it is held on trust and whether the liability was incurred on behalf of that trust, not whether the property is “permanent endowment”.

8.27 We discuss the relevance of these points to our recommendations for reform below.

## REFORMULATING THE DEFINITION OF PERMANENT ENDOWMENT

8.28 Some consultees criticised the definition of permanent endowment in section 353 as being unclear; others said that it created an unhelpful presumption that charities hold permanent endowment by treating charities as having permanent endowment “unless” particular conditions are satisfied. We have concluded that the definition is unclear and would benefit from amendment.

8.29 The definition is set out in paragraph 8.8 above. There are two limbs to the definition. The first sets out when a charity is to be treated as having permanent endowment.<sup>632</sup> The second defines permanent endowment.<sup>633</sup> Criticisms can be made of both limbs.

- (1) The first limb would appear to be redundant, since the Act no longer refers to charities that are treated as holding permanent endowment.<sup>634</sup> In addition, the first limb is intended to capture only charities holding property which is subject to rules on expenditure which distinguish between capital and income, but that is not what it achieves. Strictly, the words “without distinction between capital and income” are otiose; the existence of any restriction on expenditure of property means that “all property held for the purpose of the charity” may not “be expended for those purposes” (regardless of whether the restriction distinguishes between capital and income).
- (2) The second limb makes no reference to a distinction between capital and income, making it potentially wider than the first limb. Strictly, therefore, the second limb

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<sup>631</sup> See para 8.41 and following below.

<sup>632</sup> A charity is treated as having permanent endowment “unless all property held for the purpose of the charity may be expended for those purposes without distinction between (a) capital, and (b) income”.

<sup>633</sup> Permanent endowment means “in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity”.

<sup>634</sup> See n 619 above, explaining why that concept was required when the definition was introduced in the Charities Act 1960.

could capture “special trusts”, which comprise property held for specific purposes, narrower than the purposes of the charity (see Figure 13), because such a fund is subject to a restriction on its being expended for the purposes of the charity.

- 8.30 There is no consistency or clarity in the Act, where it refers to permanent endowment, as to whether it requires the first, second or both limbs of the test to be satisfied. For example, section 281 applies to “permanent endowment” (which is defined in the second limb), but it also refers throughout to “capital” which forms part of the first limb. Furthermore, the potentially wider scope of the second limb is not followed through elsewhere in the Act; other provisions assume that where the term “permanent endowment” is used, the restriction *does* distinguish between capital and income, and will only restrict the expenditure of capital.<sup>635</sup> It seems that, in practice, the words “without distinction between (a) capital and (b) income” from the first limb are read into the second limb, but that is a strained interpretation. Following further discussion with consultees on this issue we think that the statutory definition of permanent endowment should only capture funds where there is a restriction distinguishing between capital and income.
- 8.31 Consultees’ criticisms of the definition went further than these technical inconsistencies, but we did not consult on changing the meaning of permanent endowment in the Charities Act 2011 and we have already explained the purpose and scope of the definition above. Nevertheless, we think that the lack of clarity and technical inconsistencies in the definition could be resolved. In our view, the first limb of the definition can be removed and its reference to a restriction distinguishing between capital and income built into a single definition, based on the second limb. We recommend a reformulated definition below.
- 8.32 Our reformulated statutory definition of permanent endowment aims to capture any fund held subject to a restriction that the capital cannot be expended by any means. For example, a gift of shares subject to a restriction that only the income from the shares (namely, dividends) can be spent to further the purposes of the charity. It would not capture (1) special trust property, whereby a fund is held subject to a restriction that it can only be expended on a specific purpose; or (2) a fund held subject to a general restriction that only a certain percentage of it (whether capital or income) can be spent each year.

**Recommendation 22.**

- 8.33 We recommend that the definition of permanent endowment in section 353 of the Charities Act 2011 be reformulated to remove its inconsistencies and lack of clarity.

- 8.34 Clause 9 of the draft Bill would give effect to this recommendation.

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<sup>635</sup> See, for example, ss 104A(2)(b) and 281(3).

## SPENDING PERMANENT ENDOWMENT

- 8.35 Permanent endowment restrictions will often involve a complete prohibition on spending the funds, but they need not do so; they might only impose a limitation on how the fund can be spent.<sup>636</sup> A charity might wish to use its permanent endowment in a way that is inconsistent with the restriction on expenditure. We refer to this as “spending” permanent endowment. The charity might wish to spend its permanent endowment on its purposes over a period of time (referred to as “spending out”), or it might want to borrow from its permanent endowment by spending the capital but replenishing it over time.
- 8.36 Spending permanent endowment will usually involve spending its liquidated value, in other words (where the permanent endowment is not held as money) the proceeds of any sale of the property. Spending is to be distinguished from “converting” permanent endowment, which involves the sale of permanent endowment and using the proceeds to purchase replacement property to be used in the same way.<sup>637</sup>
- 8.37 We set out some of the reasons that charities might want to spend permanent endowment in Figure 15.

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<sup>636</sup> See n 618 above.

<sup>637</sup> See Consultation Paper, para 9.24 to 9.28 and the cases in n 607.



### Figure 15: why might charities want to spend their permanent endowment?

- (1) The fund might be so small that the costs of administering it are disproportionate to the income it yields, so it would be better to spend the fund or combine it with other funds. This was the purpose behind the original provisions in the Charities Act 1985 permitting trustees to release permanent endowment restrictions.
- (2) The charity's overwhelming need might be current, not future, leading the trustees to the view that the charity's purposes would be better served by spending part or all of the permanent endowment on its purposes now. For example:
  - a charity might need to carry out major works, such as repairs to a village hall roof, and might wish to use permanent endowment with the intention of replenishing the fund over a period of time afterwards; or
  - a charity for the relief of sickness from a particular disease for which a cure becomes available might wish to spend its permanent endowment to eradicate the disease.<sup>638</sup>
- (3) As part of a total return approach to investment,<sup>639</sup> charities might wish to spend capital in years of low income yield.
- (4) Charities might wish to make a social investment that is expected to yield a negative financial return, and to invest the remainder of the permanent endowment in such a way that any loss on the social investment is offset by expected gains elsewhere.

### The current law

8.38 There are three mechanisms by which charities can release the restrictions on spending permanent endowment.

(1) Charity Commission order or scheme

8.39 The Charity Commission can make a scheme or order that permits a charity to spend permanent endowment.<sup>640</sup> Permission will often be granted subject to a requirement

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<sup>638</sup> We are grateful to Stone King LLP for providing this example.

<sup>639</sup> See paras 8.50 to 8.54.

<sup>640</sup> The court could sanction the expenditure of permanent endowment under its inherent jurisdiction to establish a scheme for the administration of a charity (or a cy-près scheme if it involved a change of purposes). This jurisdiction was extended to the Charity Commissioners (now the Charity Commission) by the Charities Act 1960, s 18. Schemes can now be made by the Charity Commission under the Charities Act 2011, s 69(1). In addition, the Charities Act 1960, s 23, enabled the Commissioners by order to sanction the expenditure of permanent endowment if it was "expedient in the interests of the charity". The Commissioners could make an order subject to a requirement that any expenditure was recouped within a specified period. Such orders are now made under the Charities Act 2011, s 105. This power cannot, however, be used to sanction anything that is expressly prohibited by the trusts of the charity: s 105(8).

that the charity recoups that sum over a period of time to replenish the permanent endowment, in which case the charity is, in effect, borrowing from its permanent endowment rather than spending it. Recoupment is not always required.<sup>641</sup>

(2) Resolution under section 281 or 282 of the Charities Act 2011

8.40 The Charities Act 1985 conferred a very limited power on charities to release the spending restrictions on their permanent endowment if they were of the opinion that the endowment was too small for any useful purpose to be achieved by the expenditure of income alone. The power was available to charities with an annual income of up to £5 and only in respect of permanent endowment valued at up to £25.<sup>642</sup> The Charities Act 1992 extended that power to charities with an annual income of up to £1,000 and removed the cap on the value of endowment that could be freed.<sup>643</sup> The Charities Act 2006 introduced major reforms to the power,<sup>644</sup> which is now contained in sections 281 to 285, and 288 to 291, of the Charities Act 2011.<sup>645</sup>

8.41 Sections 281 and 282 set out two mutually exclusive frameworks for charities to release the restrictions on spending their permanent endowment.<sup>646</sup> Each section allows the trustees of “any available endowment fund<sup>647</sup> of a charity which is not a company or other body corporate” to resolve to release the fund, or any portion of it, from the spending restrictions that apply to it. Before exercising the power, the charity trustees have to be satisfied that the purposes set out in the trusts to which the fund was subject could be carried out more effectively if the capital, or the relevant portion of the capital, could be spent.<sup>648</sup>

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<sup>641</sup> For the circumstances in which the Charity Commission will give permission to spend permanent endowment and when it will require recoupment, see OG545-1.

<sup>642</sup> Charities Act 1985, s 4.

<sup>643</sup> Charities Act 1992, s 44. The Charities Act 2006 reintroduced a capital threshold: see para 8.42. We discuss the consequences of this in para 8.69 and following.

<sup>644</sup> The reforms were based on the recommendations in Cabinet Office Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Not-For-Profit Sector* (September 2002), paras 4.63 to 4.68, available at <http://webarchive.nationalarchives.gov.uk/+http://www.cabinetoffice.gov.uk/media/cabinetoffice/strategy/assets/strat%20data.pdf>.

<sup>645</sup> For a full description of the historical position, see the Consultation Paper, paras 9.31 to 9.36.

<sup>646</sup> In the light of the availability of these specific powers we do not believe that charities can use the power in s 280 of the Charities Act 2011 (see paras 4.32 and 4.89 above) in order to release the restrictions on spending permanent endowment. This is consistent with the view of the CLA's working group in *Response to the Charity Commission's letter on whether charities can create permanent endowment from their expendable assets* (January 2014) para 28, available at [http://charitylawassociation.org.uk/api/attachment/528?\\_output=binary](http://charitylawassociation.org.uk/api/attachment/528?_output=binary).

<sup>647</sup> “Available endowment fund” in relation to a charity means (a) the whole of the charity's permanent endowment if it is all subject to the same trusts, or (b) any part of its permanent endowment which is subject to any particular trusts that are different from those to which any other part is subject: Charities Act 2011, s 281(7). The s 281 power applies if such a fund is valued at £10,000 or less. Often, all of a charity's permanent endowment will be the “available endowment fund” because it will be subject to the same trusts. But where a charity's permanent endowment is held on different trusts, then each trust is treated separately and the s 281 power can be used for any fund valued at £10,000 or less, even if the permanent endowment as a whole exceeds £10,000.

<sup>648</sup> Charities Act 2011, ss 281(4) and 282(3).

- 8.42 Resolutions can be passed under section 281 if (a) the charity has an annual income of up to £1,000, or (b) the value of the “available endowment fund” is up to £10,000, or (c) the fund is not entirely given by one person, or two or more persons in pursuit of a common purpose.<sup>649</sup> Resolutions under section 281 take immediate effect and do not require the concurrence of the Charity Commission or any public consultation.<sup>650</sup>
- 8.43 If a resolution cannot be passed under section 281, the charity must instead follow the procedure in section 282. This will only be the case where:
- (1) the charity’s annual income is over £1,000; and
  - (2) the value of the “available endowment fund” is over £10,000; and
  - (3) the fund is “entirely given”.<sup>651</sup>
- 8.44 If any one (or more) of those conditions does not apply, the trustees can pass the resolution under section 281 instead.
- 8.45 A resolution passed under section 282 may not be implemented by the trustees unless the Charity Commission has concurred with it.<sup>652</sup> The trustees must send a copy of the resolution to the Charity Commission, which has three months to decide whether to concur with it. The Commission can direct the trustees to provide further information or give public notice of the resolution. If public notice is required, the three-month period starts when that notice is given. The resolution takes effect when the Commission concurs with it, or if the three-month period passes without the Commission responding.<sup>653</sup>
- 8.46 In deciding whether to concur with a section 282 resolution, the Charity Commission must consider the wishes of the donors and any changes in the charity’s circumstances since the gifts were made.<sup>654</sup> The Commission can only concur with a resolution if it is satisfied that its implementation would accord with the spirit of the gifts.<sup>655</sup>

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<sup>649</sup> Charities Act 2011, ss 281(2) and 282(1). The requirement for the permanent endowment to have been “entirely given” before s 282 will apply distinguishes permanent endowment donated by a person from permanent endowment created by the charity itself, for example by the accumulation of income (see OG545-1, para D1.8) or, in the context of total return investment, by the allocation of unapplied total return to the trust for investment (see paras below). There is a debate about whether charities can self-endow, that is to say, to create permanent endowment to be held on trust by its trustees: see para 8.11(4) and Analysis of Responses, Ch 9. A working group of the CLA took the view that it might be possible for a charity to self-endow: *Response to the Charity Commission’s letter on whether charities can create permanent endowment from their expendable assets* (January 2014) paras 13 and following. We discuss the “entirely given” condition in paras 8.81 and 8.82.

<sup>650</sup> Charities Act 2011, s 281(5).

<sup>651</sup> See n 649.

<sup>652</sup> Charities Act 2011, ss 282(4)(b) and 284(5).

<sup>653</sup> Charities Act 2011, s 284(5).

<sup>654</sup> Charities Act 2011, s 284(1).

<sup>655</sup> Charities Act 2011, s 284(2).

- 8.47 The financial thresholds under sections 281 and 282 can be amended by order of the Secretary of State, although that power has not been exercised.<sup>656</sup>
- 8.48 There is a parallel regime in sections 288 and 289 of the Charities Act 2011 for releasing the spending restrictions on permanent endowment held on “special trust” (see Figure 13 above).
- 8.49 Sections 288 and 289 apply when, as the result of a direction under section 12(1) of the Charities Act 2011, the special trust is to be treated as a separate charity for the purposes of these sections. Section 288 is the equivalent of section 281: the trustees of permanent endowment held on special trust may resolve to release the spending restrictions that apply to it without needing authorisation from the Charity Commission, but only if the value of the fund is £10,000 or less or if it has not been entirely given.<sup>657</sup> If the value of the fund exceeds £10,000 and it is entirely given then the power in section 289 must be used. Section 289 is the equivalent of section 282: any resolution passed under section 289 is only effective with the concurrence of the Charity Commission.

### (3) Total return investment

- 8.50 Permanently-endowed charities that adopt a traditional investment approach are constrained by the classification of investment returns (as capital or income) as to how they can apply those receipts. Capital returns have to be added to the endowment; income returns must be spent on the charity’s purposes. The trustees must balance the interests of their present and future beneficiaries by pursuing an investment strategy which balances capital and income returns.<sup>658</sup> Striking this balance has in many cases proved to be difficult and has led to sub-optimal investing (according to the nature of the return rather than its risk-adjusted value).<sup>659</sup>
- 8.51 By contrast, total return investment (“TRI”) permits charities to invest with a view to optimising the overall investment return, no matter whether that takes the form of capital or income. All investment returns are designated as “unapplied total return”. The charity then decides whether to allocate unapplied total return to the “trust for investment” (that is, treat it as capital and add it to the endowment) or to the “trust for application” (that is, treat it as income to be spent on its charitable purposes).
- 8.52 In 2001, the Charity Commission issued guidance<sup>660</sup> stating that the Commission would authorise individual charities with permanent endowment to undertake total return investment using its power under what is now section 105 of the Charities Act 2011. The guidance did not permit trustees to *spend* endowment capital where there was no

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<sup>656</sup> Charities Act 2011, s 285.

<sup>657</sup> Unlike s 281, there is no equivalent income threshold, which may make it more likely that resolutions have to be passed under the more prescriptive s 289.

<sup>658</sup> *Nestle v National Westminster Bank plc* [2000] WTLR 795; see Capital and Income in Trusts: Classification and Apportionment (2009) Law Com No 315, paras 4.10ff, 5.24ff and ch 8; Social Investment Consultation Paper, para 5.12.

<sup>659</sup> See Capital and Income in Trusts: Classification and Apportionment (2004) Law Com Consultation Paper No 175, para 6.11.

<sup>660</sup> Charity Commission, *OG83 Endowed charities: A total return approach to investment* (May 2001), now archived, available at [http://webarchive.nationalarchives.gov.uk/20110704144723/http://www.charity-commission.gov.uk/About\\_us/OGs/g083b004.aspx](http://webarchive.nationalarchives.gov.uk/20110704144723/http://www.charity-commission.gov.uk/About_us/OGs/g083b004.aspx).

unapplied total return; it emphasised that charity trustees would have to obtain separate authority to do that.

- 8.53 The Trusts (Capital and Income) Act 2013 and the Charities (Total Return) Regulations 2013 (“the TRI Regulations”) implemented the Law Commission’s recommendations to facilitate total return investment by permanently endowed charities.<sup>661</sup> They permit trustees to resolve that their permanent endowment be freed from restrictions with respect to expenditure of capital in order to invest on a total return basis, without having to seek authorisation from the Charity Commission. The trustees must attempt to value the original gift or gifts, which become the “trust for investment”, and the remainder of the fund is the “unapplied total return”. Each year, the trustees can (1) allocate some or all of the unapplied total return to the trust for application (to be spent), (2) allocate – subject to an inflation-based cap – some or all of the unapplied total return to the trust for investment, which will then be treated as part of the original gift, or (3) decide to carry forward the unapplied total return, in which case it will continue to be invested along with the trust for investment. The trustees’ decision is to be made in line with their duty of even-handedness between the current and future beneficiaries of the charity.<sup>662</sup>
- 8.54 Regulation 4 of the TRI Regulations<sup>663</sup> enables trustees to spend up to 10% of the trust for investment, subject to recoupment. The power is intended to facilitate total return investment by permitting charities to spend capital in years when investment returns are low (so there is a small, or no, unapplied total return) and replenish the capital in later years.<sup>664</sup> There is no express condition that this spending power can only be used for this purpose, and therefore nothing that expressly prevents its use for the purposes outlined in Figure 15 above. We appreciate, however, that charities would be reluctant to do so, particularly as the Charity Commission’s guidance suggests that regulation 4 cannot be used for such a purpose.<sup>665</sup>

### **The Consultation Paper and our earlier work on social investment**

- 8.55 Our consultation on permanent endowment in the Consultation Paper followed our earlier review of social investment by charities,<sup>666</sup> in which we gave detailed consideration to the social investment of permanent endowment. In that earlier work on social investment, we concluded that, all other things being equal, charities were already permitted to use permanent endowment to make social investments, other than social investments that are expected to generate a negative financial return, since this would amount to spending the permanent endowment.<sup>667</sup> If a charity wished to make such a social investment then it would first have to release the spending restrictions that

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<sup>661</sup> Capital and Income in Trusts: Classification and Apportionment (2009) Law Com No 315.

<sup>662</sup> TRI Regulations, reg 6(2).

<sup>663</sup> As authorised by the 2013 Act: see Charities Act 2011, s 104B(3).

<sup>664</sup> Capital and Income in Trusts: Classification and Apportionment (2004) Law Com No 315, ch 8.

<sup>665</sup> Charity Commission, *Total return investment for permanently endowed charities* (November 2013), para E4, available at <https://www.gov.uk/government/publications/total-return-investment-for-permanently-endowed-charities>, which states that the power “can only be used in the context of total return investment ... The power does not allow trustees to release permanent endowment for expenditure in any other situation”.

<sup>666</sup> See n 608.

<sup>667</sup> Social Investment Consultation Paper, paras 5.11 to 5.15.

applied to the relevant portion of its permanent endowment using one of the three mechanisms outlined above.

- 8.56 In the course of our earlier consultation on social investment, several consultees expressed dissatisfaction with the current procedures for releasing the spending restrictions. Some felt uncomfortable with the connotations of releasing the spending restrictions, likening it to “selling the family silver”. They questioned whether it ought to be necessary to take this step where all that is being sought is to “borrow” from permanent endowment to make a social investment (and to replenish any losses). Alternatively a charity may wish to make a social investment that will exist within a portfolio structured in such a way that any capital losses from the investment are expected to be offset by gains elsewhere (“portfolio offsetting”).<sup>668</sup>
- 8.57 We agree that the current position is unsatisfactory. In general,<sup>669</sup> trustees can invest a £10,000 permanent endowment fund in a social investment that is expected to preserve its capital value and yield an income of £1. But they cannot – without releasing the spending restrictions – invest £5,000 in a social investment that is expected to be sold the following year for £4,900 even if they expect to offset that loss through another £5,000 investment<sup>670</sup> that is expected to be sold the following year for £6,000.
- 8.58 In our report on social investment, we declined to recommend a specific power for charities to use permanent endowment to make social investments with an expected negative financial return.<sup>671</sup> Such a power would be complex,<sup>672</sup> and we were not satisfied that it would necessarily represent an improvement to the law. Moreover, we considered that the problems identified by consultees would be better addressed in a general review of the law relating to the use of permanent endowment. We undertook that more general review of the use of permanent endowment in the Consultation Paper.
- 8.59 Our consideration of permanent endowment in the Consultation Paper was split into two parts. First, we made proposals to expand and rationalise the regime governing the release of permanent endowment under the Charities Act 2011. Second, we asked whether a new regime should be created that would provide trustees with more flexibility in how permanent endowment could be used.

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<sup>668</sup> Social Investment by Charities: Analysis of Responses (September 2014), paras 3.255 and following.

<sup>669</sup> Our conclusion above is that the permitted use of permanent endowment will always depend on the particular restriction. It follows that our comments here are general; they will not necessarily apply to every permanent endowment fund: see paras 8.11 to 8.25.

<sup>670</sup> Either a social investment or a mainstream financial investment.

<sup>671</sup> Social Investment Report, paras 1.62 to 1.80.

<sup>672</sup> There would be complexity, for example, in ensuring that investments that play a recoupment or offsetting role are kept (without being too prescriptive and petrifying the portfolio); in addressing the regular changes that are made to an investment portfolio over time; in setting appropriate limits on the period over which recoupment or offsetting must take place; in setting appropriate limits on the proportion of the endowment fund that could be invested in social investments; and in addressing how recoupment or offsetting should function when there are general market failures. See Social Investment Report, n 55.

## RELEASING THE RESTRICTIONS ON SPENDING PERMANENT ENDOWMENT

### Sections 281 and 282 of the Charities Act 2011

8.60 The operation of sections 281 and 282 is explained in paragraphs 8.40 to 8.47 above. We consulted on various proposals to reform those sections.

The exclusion of corporate charities from sections 281 and 282

8.61 Sections 281 and 282 only apply to the permanent endowment “of a charity which is not a company or other body corporate”. The Charity Commission’s view is that companies can still use sections 281 and 282 in respect of their permanent endowment because (1) permanent endowment is always held on trust, and (2) the permanent endowment is a separate unincorporated charity that falls within sections 281 and 282; see paragraphs 8.11 to 8.21, and 8.26(2) above.

8.62 In the Consultation Paper, we said that, on the Charity Commission’s view, the words excluding corporate charities from sections 281 and 282 are redundant. Moreover, even if the words are not redundant – so companies which hold permanent endowment are excluded from sections 281 and 282 – there is no policy reason why they should be so excluded.<sup>673</sup>

8.63 Consultees agreed with our proposal<sup>674</sup> that sections 281 and 282 should be amended to make clear that they apply to permanent endowment held by a corporate charity.

8.64 We are not convinced that the wording that excludes corporate charities is redundant since (1) we do not agree that permanent endowment is necessarily held on trust,<sup>675</sup> and (2) the wording of section 281 does not suggest that the permanent endowment is “the charity” for the purposes of section 281.<sup>676</sup> Nevertheless, following consultation we remain of the view that the section 281 and 282 powers should be available to corporate charities in the same way that they are available to unincorporated charities.

8.65 We recommend below that sections 281 and 282 be amended to clarify that they apply to permanent endowment held by a corporate charity. This recommendation includes consequential amendments to sections 281 and 282 (and other related provisions) to confirm that references to “the charity” are to the permanent endowment fund. This ensures that there is no inconsistency between the application of these sections to permanent endowment held by corporate and unincorporated charities. The focus will always be on the permanent endowment fund in question regardless of the nature of the charity holding it.

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<sup>673</sup> Consultation Paper, para 9.53 to 9.56.

<sup>674</sup> Consultation Paper, para 9.57.

<sup>675</sup> Para 8.17 and following.

<sup>676</sup> Section 281 refers to “[the permanent endowment] of a charity which is not a company...” and to “the charity’s permanent endowment” (s 281(1) and (7)(a)). That wording suggests that the permanent endowment is not the charity itself. See also para 12.34 and following.

The financial thresholds in sections 281 and 282

### *Purpose*

- 8.66 Many consultees pointed out that the ratio in the financial thresholds between capital (£10,000) and income (£1,000) was inappropriate; a fund of £50,000 might yield an income of under £1,000, so could fall within section 281 despite the capital value far exceeding the £10,000 threshold.
- 8.67 If the two thresholds are alternative ways of seeking to identify the same sort of small permanent endowments that can properly fall within the more permissive section 281 power,<sup>677</sup> then we agree that the ratio of 10:1 is inappropriate. However, the income and capital thresholds do not focus exclusively on the permanent endowment fund to be released. The capital threshold is based on the size of the fund, whereas the income threshold is based on the size of the charity. Often, the two will not be the same thing.<sup>678</sup>
- 8.68 Under the Charities Act 1992, the equivalent (more limited) power was available to charities with an income of up to £1,000 (see paragraph 8.40 above); it was available to small charities, and the size of the permanent endowment was irrelevant. The 2006 Act was intended to expand the power so that, as well as being available to small charities, it was also available in respect of small endowment funds of up to £10,000 regardless of the size of the charity.<sup>679</sup>

### *Problems*

- 8.69 The income and capital thresholds in sections 281 and 282 cause two problems.
- 8.70 First, there is confusion as to whether the financial thresholds apply to the income and capital of the permanent endowment fund alone or whether they also include the charity's other income and capital. That in turn might depend on whether the charity is corporate or unincorporated. This can be demonstrated by the example in Figure 16.

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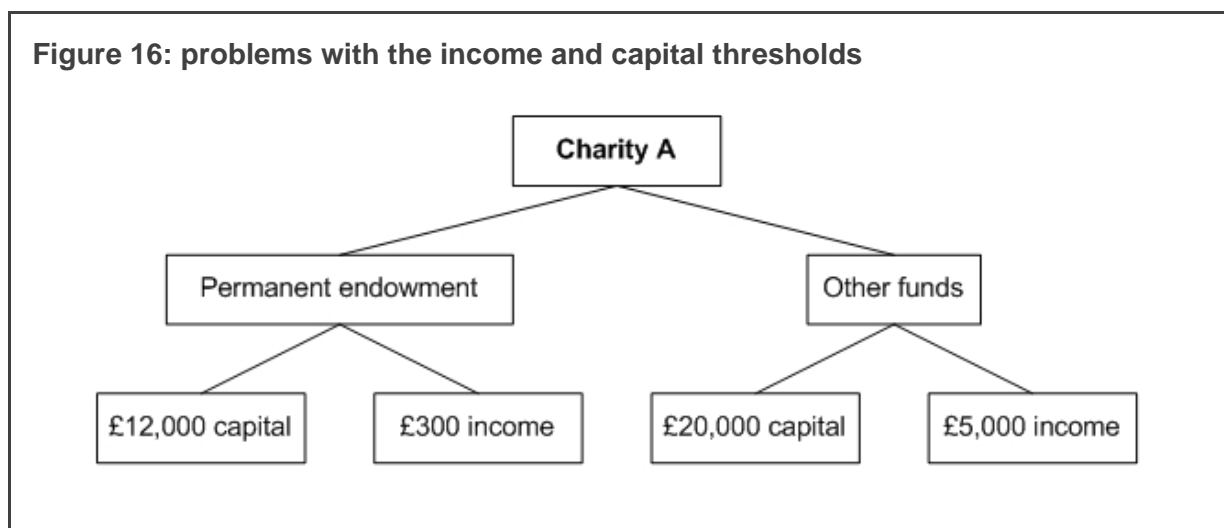
<sup>677</sup> Which is, perhaps, what the original income threshold of £5 and capital threshold of £25 in the Charities Act 1985 sought to achieve since they were cumulative requirements. If the charity exceeded either threshold, the power was not available. By contrast, the current £1,000 income and £10,000 capital thresholds under ss 281 and 282 are *alternative* conditions; if a charity falls below just one threshold, it will fall within the s 281 power (even if the other threshold is vastly exceeded).

<sup>678</sup> Subject to the argument that the permanent endowment fund is "the charity" for the purposes of sections 281 and 282: see paras 8.61 to 8.65 above.

<sup>679</sup> Cabinet Office Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Not-For-Profit Sector* (September 2002), para 4.65.



Figure 16: problems with the income and capital thresholds



8.71 In Figure 16, the charity's gross income is £5,300, and the value of the permanent endowment is £12,000, so the permanent endowment restriction cannot be released under section 281 (because the charity's income exceeds £1,000 and the value of the fund exceeds £10,000).

8.72 But if the charity is a company, then – as explained above – it is widely believed that the permanent endowment constitutes a separate charity as a matter of charity law.<sup>680</sup> If that is correct, then the “charity” (namely the permanent endowment fund) has an income of just £300, so the permanent endowment restriction can be released under section 281 (because, despite the value of the fund exceeding £10,000, the charity's income does not exceed £1,000).

8.73 The permanent endowment fund is in both cases exactly the same, but it is treated differently under sections 281 and 282 depending on whether the charity is a trust or company. On this analysis, it is harder for a charitable trust to use section 281 than for a charitable company.<sup>681</sup> The inconsistency would disappear if (contrary to the current understanding) a company's permanent endowment was not treated as a separate charity.<sup>682</sup> The inconsistency would also disappear if permanent endowment were always treated as a separate charity for the purposes of sections 281 and 282,<sup>683</sup> so that in the example in Figure 16 the section 281 power could be used regardless of the form of the charity.

8.74 Second, in some circumstances, section 281 can be used when the value of the permanent endowment is high, but the threshold applies illogically and arbitrarily.

<sup>680</sup> See paras 8.11(2), 8.20 to 8.21. It is on this basis that the existing words confining ss 281 and 282 to charities that are not corporate bodies can be satisfied; the permanent endowment held by a company is itself a separate (unincorporated) charity.

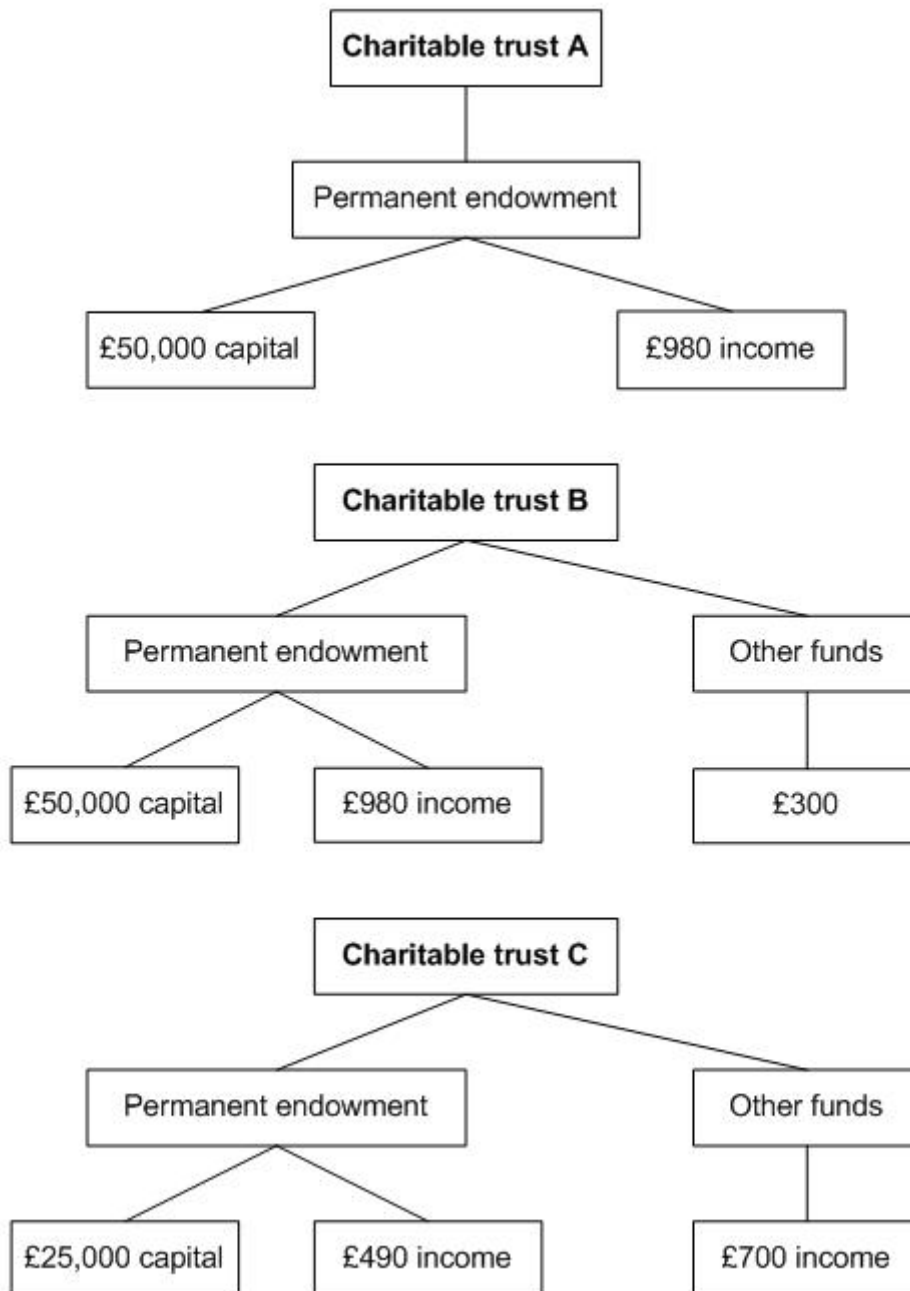
<sup>681</sup> This was pointed out by Bates Wells Braithwaite and the CLA.

<sup>682</sup> Which, however, in turn would preclude companies from using ss 281 and 282 at all: see para 8.61.

<sup>683</sup> As explained in n 676 above, this interpretation does not sit comfortably with the wording of s 281.

8.75 In Figure 17, the sole source of income for Charity A is from its permanent endowment, valued at £50,000. That permanent endowment might produce an annual income of £980 (roughly a 2% return). The permanent endowment restriction could be released under section 281 (because the charity's income is below the £1,000 threshold). But if the same charity had additional sources of income, say donations of £300 (Charity B), it could only release its permanent endowment under section 282 (because both the charity's capital and income are above the thresholds). And if the permanent endowment was valued at just £25,000 producing an income of £490, but the charity had donations of £700 (Charity C), then the restriction could only be released under section 282 (because the charity's capital and income would still be above the thresholds).

**Figure 17: problems with the income and capital thresholds**



8.76 In summary, the result of the income threshold is that:

- (1) permanent endowment funds of the same value can be treated differently (compare Charities A and B); and
- (2) a large permanent endowment fund can fall within the section 281 power whilst a smaller fund falls outside the section 281 power (compare Charities A and C);

depending, arbitrarily, on whether the charity has other sources of income.

### *Conclusion*

8.77 The current operation of the financial thresholds in sections 281 and 282 produce results that are uncertain, complicated, illogical and arbitrary.

8.78 In our view, the availability of the section 281 power should not depend on:

- (1) whether the charity is a company or a trust;
- (2) whether the permanent endowment is a separate charity; or
- (3) the income of the charity as a whole.

8.79 The two problems explained above would be solved if the availability of the section 281 power depended solely on the size of the permanent endowment fund (and not on the matters identified in paragraph 8.78). First, permanent endowment funds would be treated in the same way, regardless of the legal form of the charity; the power available to release the permanent endowment in Figure 16 would not depend on whether the charity was a trust or a company. Second, permanent endowment funds would be treated in the same way, regardless of the charity's other income; the power to release the permanent endowment of Charities A and B in Figure 17 would be the same.

8.80 We have said that the availability of the section 281 power should depend on the size of the endowment fund, by which we mean the "available endowment fund", namely the whole of a fund which is subject to the same restriction.<sup>684</sup> Even if only part of the fund is to be released, the threshold is based on the size of the fund as a whole.<sup>685</sup> A charity might have more than one "available endowment fund" (for example, different university prize funds); the availability of the section 281 power would depend on the size of each fund.

### The "entirely given" condition

8.81 The gateway to section 281 includes a third, rather obscure provision based on whether the permanent endowment fund was "entirely given" by a donor or by several donors in pursuit of a common purpose. The provision is not well understood. The Charity Commission said it "struggled to understand" the provision and the University of Plymouth thought it should be removed. It seems that this provision was included in

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<sup>684</sup> See n 647 above.

<sup>685</sup> If, by contrast, the availability of the s 281 power depended on the size of the portion of the fund to be released, a charity could release that much of its permanent endowment by successive resolutions, thereby releasing a far larger capital sum without Charity Commission oversight.

order to protect permanent endowment funds given by donors (as opposed to funds created from accumulated income or directed by the Charity Commission to be held as permanent endowment), by requiring the release of such permanent endowment funds to require Charity Commission oversight under section 282. The provision, in fact, has the opposite effect. The section 281 power (which does not require oversight) can be used if *any part* of the fund comprises any accumulated income,<sup>686</sup> even if the permanent endowment fund is large and even if the charity's income is high. The requirement to use section 282 can, in effect, be evaded if any part of the permanent endowment was not "entirely given".

- 8.82 We have concluded that the "entirely given" condition should be removed. It is unclear and creates a loophole in sections 281 and 282.

The new financial threshold in sections 281 and 282: quantum

- 8.83 Lord Hodgson's report suggested that the threshold based on the size of the permanent endowment fund should be increased from £10,000 to £100,000 and that the income threshold should be increased from £1,000 to £10,000.<sup>687</sup> We have concluded that the availability of the section 281 power should depend on the value of the "available endowment fund" and not on the charity's income.
- 8.84 Lord Hodgson's report did not suggest any particular reason for proposing a tenfold increase to £100,000 for the capital value of the fund (and £10,000 for the income threshold). Consultees generally agreed that the thresholds should be increased, but they expressed a range of views as to the appropriate financial thresholds; their views appear to have been based on instinct as they were not accompanied by any analysis as to why a particular figure was appropriate. Many consultees adopted Lord Hodgson's recommendation of £100,000 for the capital value of the fund. Few advocated a higher figure,<sup>688</sup> but some suggested it should be lower with £25,000 being the most common alternative suggestion.

*Should the threshold be increased?*

- 8.85 The arguments against increasing the threshold are that Charity Commission oversight is necessary to maintain trust and confidence in charities, and that donors who make large gifts subject to permanent endowment restrictions would expect the release of those restrictions (if permitted at all) to be overseen by the Charity Commission. We have concluded, however, that the threshold should be increased. Permanent endowment restrictions can only be released under sections 281 and 282 if the trustees are satisfied that it would allow the fund's purposes to be carried out more effectively. Trustees remain subject to their duty to act in the best interests of the charity (both now and in the future) and they should be trusted to exercise the power carefully and only in appropriate circumstances. Increasing the threshold, so that more permanent endowment funds could be released under section 281 rather than section 282 would reduce bureaucracy and costs for charities and the Charity Commission, and it would

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<sup>686</sup> Or any funds that were added to the permanent endowment from the charity's unrestricted funds, if it is within the charity's power to do so (about which there is some debate: see n 649 above).

<sup>687</sup> Hodgson Report, Appendix A, para 27.

<sup>688</sup> University of Plymouth suggested £200,000 and NCVO, ACF, CFG and IoF (in their joint response) suggested £1m for grant-making foundations, and £100,000 for all other charities.

provide greater flexibility for trustees. We have therefore concluded that it is appropriate to increase the threshold.

*What should the threshold be?*

- 8.86 Ultimately, setting a threshold is a value judgement and is, to some extent, arbitrary. We are not aware of any data concerning the number of endowment funds of different sizes in order to assess how many more funds would fall within section 281 by increasing the threshold by different amounts. Nor, we have concluded, is it possible to devise objective criteria from which to derive a logical result.
- 8.87 To update the current £10,000 capital threshold (which was set in 2006) in line with inflation would produce a threshold of £13,300,<sup>689</sup> and in line with investment performance would produce a threshold of £12,600.<sup>690</sup> We note the support for a £100,000 threshold, but we are also mindful of the concerns of many consultees that that figure would be too high. We think that trustees can be expected to exercise the section 281 power carefully whatever the size of the fund, but the requirement for Charity Commission oversight creates a further incentive for trustees to act reasonably since they know their decision will be reviewed, and it protects large funds. We have concluded that, in the first instance, the section 281 power should be available in respect of permanent endowment funds worth up to £25,000, and that the release of larger funds should be subject to Charity Commission scrutiny under section 282.
- 8.88 This threshold represents a compromise between the various views that were expressed by consultees, and importantly it is not the last word on the matter. The threshold can be increased by secondary legislation and we would encourage the Charity Commission and Department for Digital, Culture, Media and Sport to review this threshold every five years and to increase (or decrease) it in the light of its operation in practice.<sup>691</sup> It may be that an increase to £100,000, as suggested by Lord Hodgson and other consultees, would be appropriate, but it seems to us a very significant increase which could remove some very large permanent endowment funds from Charity Commission oversight. We prefer a more cautious incremental approach, which would allow the Charity Commission to assess whether the power is being used appropriately and whether it should be extended further.

Procedural requirements in sections 281 and 282

- 8.89 Consultees unanimously agreed with our proposal that the time limit for the Charity Commission to respond to a resolution under section 282 should be reduced from three months to 60 days.<sup>692</sup>
- 8.90 The CLA noted inconsistencies in the running of the time limits in respect of section 282 resolutions as compared with section 275 resolutions. A section 282 resolution takes effect three months after it is received by the Commission or, if the Commission directs the charity trustees to give public notice of the resolution, three months after that notice

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<sup>689</sup> Based on the inflation calculator at <http://www.bankofengland.co.uk/education/Pages/resources/inflationtools/calculator/default.aspx>.

<sup>690</sup> Based on the change in the FTSE 100 index between 2006 (approx. 5,900) and 2017 (7,450).

<sup>691</sup> See also our recommendations regarding inflation adjustment at paras 3.14 to 3.17 above.

<sup>692</sup> Consultation Paper, para 9.63.

is given, unless within that period the Commission objects to the resolution.<sup>693</sup> If the Commission directs the trustees to provide further information,<sup>694</sup> the three-month time limit continues to run from the date of the Commission's receipt of the resolution. Accordingly, unless the trustees can provide the information quickly, the Commission might be compelled to object to the resolution (to avoid the three-month time period expiring), leaving the trustees to start the process afresh. In addition, the Charity Commission can effectively "re-start" the three-month time limit for considering a section 282 resolution by requiring public notice to be given.

- 8.91 By contrast, resolutions under section 275 take effect 60 days after they are received by the Commission, unless within that period the Commission objects to the resolution. If the Commission directs the trustees (a) to give public notice of the resolution or (b) to provide further information, the 60-day time limit is suspended while the direction is complied with.<sup>695</sup> The period is suspended until 42 days after public notice is given, or until the additional information is provided, as the case may be.<sup>696</sup>
- 8.92 We prefer the procedural requirements that apply to section 275 resolutions. They make clear that the time limit starts running as soon as the Charity Commission receives the resolution (rather than the Charity Commission being able to re-start the time limit by directing public notice to be given). They also permit the time limit to be suspended to allow charity trustees to respond to a request by the Charity Commission for further information. We therefore recommend that the procedural requirements in respect of section 282 resolutions be amended to reflect those that apply to section 275 resolutions.
- 8.93 Finally, a section 282 resolution takes effect when the charity trustees are informed by the Charity Commission that it concurs with the resolution or, if later, at the expiry of the three-month period mentioned above. The CLA, Bircham Dyson Bell LLP and Stone King LLP said it would be helpful if the trustees could choose a later date, for example to coincide with the end of the charity's financial year. In other contexts charities can specify a date on which a resolution takes effect.<sup>697</sup> We think, however, that a similar approach in section 282 would create practical difficulties. The 60-day period within which the Commission must object to a section 282 resolution can be suspended when the Commission asks for further information or requires that public notice be given. The trustees cannot predict at the outset whether the Commission will require them to take that action, or how long it will take to do so. So when trustees pass a section 282 resolution, they will not be able to specify a date on which it should come into effect and know with certainty that that date will be valid. We do not therefore think that it would be particularly useful to allow trustees to specify a date in a section 282 resolution, and it could in fact be unhelpful since there would be a danger of reliance being placed on

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<sup>693</sup> Charities Act 2011, s 284(3) to (5).

<sup>694</sup> Under Charities Act 2011, s 283(2).

<sup>695</sup> Charities Act 2011, ss 276 to 278. See para 4.30.

<sup>696</sup> Subject to a maximum suspension of 180 days.

<sup>697</sup> For example, when the resolution takes effect under section 281 (s 281(6)), and when an amendment to the articles of a charitable company take effect (see paras 4.7 and 4.11). In Ch 4, we also recommend that amendments to an unincorporated charity's governing document under the statutory power that we recommend, and amendments to a CIO's constitution, should take effect on a date specified in the resolution: see paras 4.13, 4.23 and 4.121(5).

the date specified in the resolution even if the 60-day relevant period had not at that point expired (because it had been suspended). No consultee provided a specific example of where the lack of such a power in the current law has proven problematic. We have concluded that section 282 should not be amended to allow trustees to specify a date on which the resolution should take effect.

### **Sections 288 and 289 of the Charities Act 2011**

8.94 The regime in sections 281 and 282 is mirrored in section 288 and 289 for “special trusts”. We have concluded that the latter provisions are redundant. Any permanent endowment which is a “special trust” would fall within the definition of the “available endowment fund” in sections 281 and 282, so those powers would be available to release the restriction.

8.95 Consultees generally considered sections 288 and 289 to be unnecessary and confusing. We were not told of any cases in which section 288 and 289 had been used. Nor did any consultees raise any actual or hypothetical cases in which those sections could be used but where sections 281 and 282 would have been unavailable. No consultee disagreed with our proposal to repeal sections 288 and 289 and we make a recommendation accordingly.<sup>698</sup>

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<sup>698</sup> Repealing ss 288 and 289 (along with the sections relating to it) would leave only one provision in Part 14 of the Charities Act 2011, namely, s 287, which defines “special trusts”. The draft Bill therefore repeals Part 14 in its entirety and moves the definition of special trusts into s 353: see cl 14.

## Releasing the restrictions on permanent endowment: recommendations for reform

### Recommendation 23.

8.96 We recommend that:

- (1) the power to release permanent endowment restrictions in sections 281 and 282 of the Charities Act 2011 should be available to all charities, and the potential exclusion of corporate charities should be removed;
- (2) the power to release permanent endowment restrictions in section 281 should depend on the value of the permanent endowment alone, and that the income threshold and the “entirely given” condition in section 282(1) should be removed;
- (3) the power to release permanent endowment restrictions under section 281 should be available in respect of permanent endowment funds of a value up to £25,000;
- (4) the time limit for the Charity Commission to respond to a resolution under section 282:
  - (a) should be reduced to 60 days;
  - (b) should commence when the resolution is received by the Charity Commission;
  - (c) (when the Commission directs the charity trustees to give public notice of the resolution) should be suspended until 42 days after public notice is given;
  - (d) (when the Commission directs the charity trustees to provide further information about the resolution) should be suspended until that information is provided to the Commission; and
- (5) the parallel regime for “special trusts” in sections 288 and 289 of the Charities Act 2011 should be repealed.

8.97 Clauses 10, 11 and 14(1) of the draft Bill would give effect to this recommendation.

### TOTAL RETURN INVESTMENT

8.98 Professor Duncan Sheehan suggested various reforms to the TRI Regulations. He thought that the inflation-based cap on allocating unapplied total return to the trust for investment<sup>699</sup> should be removed, since trustees might quite properly wish to increase the endowment capital. This suggestion raises questions about appropriate

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<sup>699</sup> See para 8.53.



accumulation of income<sup>700</sup> and concerns about tying up capital. We do not think that it is a pressing concern since the unapplied total return is treated in the same way as the trust for investment until it is allocated to the trust for application.<sup>701</sup> We did not specifically consult on the inflation-based cap in the TRI Regulations and we note that the Charity Commission is due to review the TRI Regulations by the end of 2018.<sup>702</sup> We will pass on these comments to the Charity Commission for it to consider as part of that review.

8.99 Professor Sheehan also thought that charities should be permitted to spend more than 10% of the trust for investment under regulation 4 (subject to recoupment) with the Charity Commission's consent. We see the strength of that argument, which we address below when considering more generally the power to borrow from permanent endowment.<sup>703</sup>

## A NEW FORM OF PERMANENT ENDOWMENT

### Problems with the current law

8.100 In the Consultation Paper, we raised the possibility of creating a new regime governing permanent endowment which would provide trustees with flexibility as to how the fund could be used and would create a safeguard to ensure that the real value of the permanent endowment was preserved in the long term. We said that the purpose of the new regime would be to respond to two problems that exist with permanent endowment restrictions under the current law. First, the requirement for capital preservation, which prevents trustees from investing in assets that are expected to depreciate in capital value (including social investments with an expected negative financial return). Second, the absence of a requirement that the real value of the endowment be maintained in the long term. Some consultees disagreed that these problems existed under the current law. We therefore re-consider those issues before discussing the desirability of a new regime.

#### (1) Assets that depreciate in capital value

8.101 In the Consultation Paper, we said that "trustees' obligation is to preserve the actual, pound for pound value of the fund" and that permanent endowment is spent "when it is invested in such a way that capital value is lost, for the sake of a particularly high income yield". Trustees cannot therefore "balance or offset losses and gains within the fund; they do not have the freedom to invest permanent endowment in a fund expected to yield high income but to lose capital and offset that with expected capital gains from another investment."<sup>704</sup> The effect is that trustees could not purchase an asset for £1,000 if they expected its capital value to fall to £900, even if they expected the asset

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<sup>700</sup> See The Rules Against Perpetuities and Excessive Accumulations (1998) Law Com No 251; Perpetuities and Accumulations Act 2009.

<sup>701</sup> TRI Regulations, reg 3(4). Additionally, if a charity reverts from total return investment to the standard investment approach, any unapplied total return (which cannot be allocated to the investment fund by reason of the inflation cap) will be treated as expendable endowment, so can still be preserved by charity: reg 8(4).

<sup>702</sup> TRI Regulations, reg 9.

<sup>703</sup> Paras 8.124 to 8.136.

<sup>704</sup> Consultation Paper, paras 9.21 and 9.22.

to yield an income of £300 and if they expected the capital loss to be offset by a capital gain of £150 from another asset in the portfolio.

8.102 Some consultees disagreed with this analysis.<sup>705</sup> They said that the requirement to maintain capital applies to the portfolio as a whole, not a single investment. Further, it is standard practice (and recommended by professional investment advisers) for permanently endowed charities to invest in capital-depreciating assets. A balanced portfolio will often include government or corporate bonds which are expected to depreciate in capital value over time but are purchased for the sake of their income yield.

8.103 As with the various assumptions in paragraph 8.11 above, we have concluded that there is no comprehensive and universal answer to the question of whether permanent endowment can be invested in capital-depreciating assets; it will depend on the terms of the particular permanent endowment restriction. We remain of the view that some permanent endowment restrictions might prevent this investment approach.<sup>706</sup> We accept, however, that it is standard practice and recommended by professional investment advisers, so even if it is strictly prohibited there is unlikely to be any challenge to a charity's decision in good faith to invest in such assets when it leads to no overall loss to the endowment fund.

8.104 Where a charity operates a total return approach to investment, it will be permitted to invest in capital depreciating assets since that regime concentrates on the overall return, not the classification of the return as income or capital. In the example above, there would be a £200 net return from the asset in question<sup>707</sup> (in addition to the returns from other assets in the portfolio).

8.105 We also remain of the view that most permanent endowment restrictions will prevent charities from making social investments with an expected negative financial return.<sup>708</sup> If a charity pays out £1,000 only expecting to receive £900 back, it will, in effect, have spent £100; put another way, the transaction was not an "investment" so is unlikely to be permitted.<sup>709</sup> That is the case even if they anticipate a capital gain of £150 elsewhere in the portfolio.

## (2) Preservation of real value

8.106 We said that, as the obligation is to preserve the pound-for-pound value of the fund, "there is no obligation to maintain the real value of the permanent endowment, allowing

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<sup>705</sup> Charity Investors' Group, NCVO, ACF, CFG and IoF.

<sup>706</sup> If the restriction is "to invest the fund and spend the income on the charity's purposes", then capital-depreciating assets might be permitted since the acquisition of those assets, together with other appreciating assets, might fall within the meaning of "invest". See Social Investment Consultation Paper, para 3.31 to 3.38 on the meaning of "investment". By contrast, if the restriction is "to preserve the capital", then purchasing a capital-depreciating asset might not be permitted.

<sup>707</sup> The capital loss of £100 plus the income gain of £300 gives a total return of £200.

<sup>708</sup> We explain the meaning of "negative financial return" in fig 13 and n 609 above. Whether such social investments are permitted will – like any other transaction – depend on the terms of the particular restriction.

<sup>709</sup> We discuss the meaning of "investment" in the Social Investment Consultation Paper, paras 3.31 to 3.38.

for inflation.”<sup>710</sup> We noted that the trustees’ duty of even-handedness might require them to maintain the real value, but the source of that duty is not the permanent endowment restriction.<sup>711</sup>

8.107 Consultees did not report that this created problems in practice. Some said that there was no problem since a failure to seek to maintain the real value of the capital would amount to a breach of trust because the trustees would not be complying with their duty of even-handedness between current and future beneficiaries.<sup>712</sup> We think that there remains a possibility, in theory, of trustees only maintaining the actual value of permanent endowment without being in breach of trust.<sup>713</sup> We accept, however, the views of those consultees who said that this does not present a problem in practice. Indeed, in our earlier project which considered total return investment by charities, we concluded (albeit in the context of total return investment and not a more wholesale review of permanent endowment):

In itself, the absence of any formal mechanism to retain the real value of the endowed gift is not problematic, provided that trustees who operate the [total return investment] scheme appreciate the need to keep in mind the effect of inflation on the value in real terms of the endowed gift.

8.108 We consider the effect of these consultees’ views about the current law on the need for a new regime below. Before doing so, we comment briefly on consultees’ views about the desirability of such a new regime.

### **Appetite for a new regime**

8.109 We said that a new regime would have two main features:

First, it would give trustees wide powers as to how they used the fund. There would be no prohibition on spending the capital fund and so no restriction (in principle) on using the fund to make an investment that is expected to make a loss, provided that the trustees devise a suitable plan for replenishing that loss, for example by offsetting short-term losses against long-term gains from other investments. Second, the new regime would impose a duty on trustees to seek to ensure that the real value, and not just the actual value, of the fund is maintained in the long term. Trustees would have to devise a policy setting out how they would seek to achieve this.

When compared with existing permanent endowment restrictions, such a regime could put substance over form by securing the perpetual continuation of the charity. It would also allow flexible use of permanent endowment assets without the stigma of

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<sup>710</sup> Consultation Paper, para 9.22.

<sup>711</sup> Consultation Paper, para 9.73.

<sup>712</sup> Francesca Quint; Bates Wells Braithwaite; the CLA, with whom Bircham Dyson Bell LLP agreed; National Trust; and Prof Duncan Sheehan.

<sup>713</sup> The duty of even-handedness is a broad concept. Its application to a given case is fact-specific and trustees have a degree of flexibility in how they discharge their duties. We therefore do not think that it can be said that the duty universally requires trustees to seek to maintain the real value of permanent endowment. See our discussion of the duty in *Capital and Income in Trusts: Classification and Apportionment* (2004) Law Commission Consultation Paper No 175, paras 5.19 to 5.26; and (2009) Law Com No 315, paras 4.10 to 4.16.

“spending” it, by placing the emphasis on preserving them. The fund would become a more useful asset but its real value would be maintained, in a way that the law relating to permanent endowment, by contrast, does not guarantee.<sup>714</sup>

8.110 In the Consultation Paper, we said that “such a regime would not be simple to devise” and highlighted some of the difficulties that would need to be addressed.<sup>715</sup> We asked consultees for their views as to whether they would support a new regime as well as their suggestions as to how it might operate.<sup>716</sup>

8.111 Some consultees expressed strong support for a new regime that would allow charities to use their permanent endowment more flexibly. Permitting more flexible use of capital and ensuring maintenance of the real value of the capital could be a “win, win situation”.<sup>717</sup> One consultee thought its “ability to deliver [its] charitable objectives could be enhanced” by a new regime.<sup>718</sup>

8.112 Many consultees who disagreed with our assessment of the problems under the current law (as set out above) consequently thought that there was no need for a new regime for permanent endowment. They, and others, expressed strong reservations about whether a new regime was desirable and whether it could work in practice; they emphasised the difficulties that we had raised and tended not to suggest solutions. In summary, it was thought that a new regime would:

- (1) lead to increased bureaucracy, costs and complexity, and hazard for charity trustees;
- (2) be difficult to operate in practice, to monitor, to audit and to report on;
- (3) undermine donor confidence; and
- (4) potentially drive trustees to:
  - (a) make unduly conservative investment decisions;
  - (b) make unduly risky investment decisions; and/or
  - (c) reduce their spending in times of low investment returns.

8.113 Other consultees emphasised that the existing procedures to release permanent endowment restrictions were adequate and that much of what a new regime sought to achieve could already be done as part of total return investment, with some modification.

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<sup>714</sup> Consultation Paper, paras 9.76 and 9.77.

<sup>715</sup> Consultation Paper, para 9.78.

<sup>716</sup> Consultation Paper, paras 9.79 and 9.80.

<sup>717</sup> Anthony Collins Solicitors LLP.

<sup>718</sup> UnLtd.

## Discussion

8.114 There was not widespread support for a new regime, owing to consultees' views that the operation of the current law in practice allowed flexibility to invest in capital-depreciating investments and generally saw trustees seeking to maintain the real value of the endowment. That being the case, the impetus for a new regime is diminished. As we discuss below, we think that there are other ways to address the particular problems that are experienced in practice. Furthermore, we agree with those consultees who thought that the problems in designing a new regime, which were anticipated in the Consultation Paper, would be difficult to overcome. We have therefore concluded that a new regime should not be created.

8.115 In the light of that conclusion, the force of the criticisms set out in paragraph 8.112 is less significant and we do not consider them in any detail here.<sup>719</sup>

### Social investments with an expected negative financial return

8.116 There remains, however, the problem that social investments with an expected negative financial return cannot generally be made using permanent endowment. In our recommendations on social investment, we said that we saw the benefit of permitting charities to engage in "portfolio offsetting", namely using permanent endowment to make social investments with a negative financial return when they expect to offset any losses by gains elsewhere in the portfolio.<sup>720</sup> In addition, if trustees want to borrow from their permanent endowment to make social investments, replenishing any losses, we think that they should be permitted to do so.<sup>721</sup> Whilst we have concluded that this problem alone does not justify the creation of a new regime for permanent endowment, we do think that the current law can be changed to facilitate it.

#### The current law

8.117 As we noted in our Social Investment Report,<sup>722</sup> many social investments are expected to yield a positive financial return. Such social investments can generally be made using permanent endowment.<sup>723</sup> It is only social investments with a negative (or highly uncertain) return that are likely to present a problem. Figure 18 explains how such social investments can be made using permanent endowment under the current law.

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<sup>719</sup> For a full explanation of those concerns, see the Analysis of Responses, Ch 9.

<sup>720</sup> See para 8.57 and Social Investment Report, para 1.65 and following.

<sup>721</sup> Though we do not expect that trustees would be particularly keen to do so since it would treat social investments differently from mainstream financial investments. It would place the onus on trustees to recoup any losses from social investments, whereas any losses from social investments which are treated as true "investments" would not have to be replenished (in the same way that losses in mainstream financial investments do not have to be recouped in the event of losses stemming from a fall in the market). See Social Investment Report, para 1.65(1)(b).

<sup>722</sup> Social Investment Report.

<sup>723</sup> Social Investment Report, paras 1.60 to 1.64; see too s 292A of the Charities Act 2011, inserted by the Charities (Protection and Social Investment) Act 2016, s 15, implementing our recommendation that the statutory power to make social investments be available in respect of permanent endowment subject to compliance with the particular restriction on spending.

## Figure 18: permanent endowment and social investments with a negative financial return – the current law

### Standard investment approach

Permanent endowment restrictions can be released under sections 281 and 282. Whilst the use of those sections might suggest that the fund is going to be spent, it need not be. Sections 281 and 282 can be used simply to convert a permanent endowment fund (or part of it) into an expendable endowment. A desire to make negative return social investments might be a good reason to exercise that power.

The charity can seek authorisation from the Charity Commission under section 105 to use permanent endowment to make social investments with a negative financial return. Depending on the circumstances, such authorisation may, but need not, be given subject to a condition that any losses are recouped over time.

### Total return investment

If a permanently endowed charity has opted in to total return investment, the position is complicated.

- (1) The trust for application can be spent, so can also be used to make social investments with a negative financial return.
- (2) Any part of the unapplied total return can be allocated to the trust for application (in line with the trustees' duty of even-handedness) and, once allocated, can be used to make social investments with a negative return.
- (3) Regulation 4 permits charities to spend up to 10% of the trust for investment subject to recoupment, so this could – in theory – be used to make social investments with a negative return, although trustees are unlikely to exercise the power for this purpose.<sup>724</sup>
- (4) It is unlikely that the trust for investment can be used to make social investments with a negative return; the permanent endowment restrictions are only released in order that the fund “be *invested* without the need to maintain a balance between capital and income returns”.<sup>725</sup> Accordingly, the requirement that the capital be “invested” remains and, as a social investment with a negative financial return is not an “investment”,<sup>726</sup> it ought not to be made using the trust for investment.
- (5) It might be possible to use the unapplied total return to make social investments with a negative financial return (without having first to allocate it to the trust for application), since this is the total return on the original endowment, rather than the original endowment itself. However, until it is allocated, the unapplied total return “shall be dealt with in the same way as the trust for investment”<sup>727</sup> so arguably the unapplied total return cannot be used to make social investments with a negative financial return any more than the trust for investment.<sup>728</sup>

## Consultation responses

8.118 In the Consultation Paper, we said that trustees might be reluctant to use the existing mechanisms to make social investments with a negative financial return for fear of being accused of “selling the family silver”.<sup>729</sup> Some consultees commented that the existing mechanisms were unsatisfactory.<sup>730</sup>

8.119 Some consultees thought that there should be a general power to borrow from permanent endowment without having to obtain the Charity Commission’s authorisation, either instead of or as part of a new regime.<sup>731</sup>

8.120 Others thought that a new power could be introduced for social investment alone.<sup>732</sup> It was also suggested that portfolio offsetting could be achieved using the TRI Regulations, and that there was no need to “reinvent the wheel”.<sup>733</sup>

## The role of total return investment

8.121 Total return investment (“TRI”) was not designed to permit trustees to make social investments with a negative financial return. As we explain in paragraph 8.51 above, TRI solves the difficulty that arises from the classification of investment returns as income or as capital. But it remains designed for investments that are expected to yield a positive financial return. Social investments with a negative financial return are not “investments” and so cannot generally be made using permanent endowment whether the charity invests on the standard basis or on a TRI basis. We discuss in Figure 18 above the limited extent to which charities that operate TRI can use their permanent endowment to make social investments with a negative financial return, principally by using the regulation 4 power to borrow 10% of the trust for investment.

8.122 Whilst TRI was not designed for, nor generally does it permit, the making of social investments with a negative financial return, the TRI regime naturally lends itself to portfolio offsetting. That is because both TRI and portfolio offsetting focus on the overall return from a portfolio. Further, as we explain below, the TRI regime has other features that could usefully be adopted in permitting portfolio offsetting. We agree with those consultees who suggested that, with some amendment, the TRI Regulations could be used to permit portfolio offsetting with the entire endowment (which, for the reasons

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<sup>724</sup> See para 8.54.

<sup>725</sup> Charities Act 2011, s 104A(2)(a), emphasis added.

<sup>726</sup> See para 8.105.

<sup>727</sup> TRI Regulations, reg 3(4).

<sup>728</sup> This is contrary to the view that we expressed in the Social Investment Report, n 47.

<sup>729</sup> Consultation Paper, para 9.74. The point was made by consultees in response to our consultation on social investment: see Social Investment Report para 1.75.

<sup>730</sup> Social Finance; NCVO; ACF; CFG; IoF; and National Trust.

<sup>731</sup> Francesca Quint; Veale Wasbrough Vizards LLP; National Trust; and Charity Commission. Lord Hodgson’s original recommendation was that charities should be given a power to borrow from permanent endowment, subject to recoupment, for the purpose of social investment: Hodgson Report, ch 9, recommendation 3.

<sup>732</sup> The CLA; Bircham Dyson Bell LLP; and Bates Wells Braithwaite.

<sup>733</sup> Prof Duncan Sheehan; Prof Gareth Morgan; National Trust; NCVO; ACF; CFG and IoF.

given in Figure 18, is not currently possible). That would not, however, be a complete solution since some charities will not wish to adopt TRI. It cannot be assumed that charities wishing to make social investments with a negative financial return will also want to opt in to TRI;<sup>734</sup> some will want to do one but not the other.

## RECOMMENDATIONS FOR REFORM

8.123 We agree with consultees that there should be a power for trustees to borrow from permanent endowment without having to obtain the Charity Commission's authorisation, and that there should be a specific power for trustees to make social investments with a negative financial return within the TRI Regulations in order to facilitate portfolio offsetting. These two additional powers for trustees would cover different situations, but, as we explain below, they would complement each other.

### (1) A power to borrow from permanent endowment

8.124 Trustees might wish to borrow from their permanent endowment in order to make social investments with a negative financial return. But they might wish to do so for numerous other reasons, such as to repair the village hall roof, to construct a new building, or to purchase equipment. The trustees might decide that it would be preferable to borrow from the charity's permanent endowment rather than to borrow money at a commercial rate of interest.

8.125 Trustees can already seek authorisation from the Charity Commission to spend and replenish permanent endowment under section 105. As noted above, a power to borrow was favoured by some consultees, either instead of or as part of a new regime.<sup>735</sup> We have concluded that charities should be given a statutory mechanism to borrow from their permanent endowment, subject to recoupment, without having to obtain authorisation from the Charity Commission.<sup>736</sup> The recommended power would permit trustees to borrow for any purpose, including to make social investments with a negative financial return.<sup>737</sup>

8.126 The recommended power is intended for investment permanent endowment. It cannot be used to enable trustees to borrow from functional permanent endowment. In practice, the borrowing power requires trustees to liquidate the particular assets and replenish them later; there is no third party lender providing funds to be secured against the permanent endowment as there would be if the trustees granted a mortgage over functional permanent endowment to secure borrowing from a bank.

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<sup>734</sup> This point was made by NCVO; ACF; CFG; and IoF.

<sup>735</sup> See para 8.119.

<sup>736</sup> In theory, ss 281 and 282 could be used by trustees wishing to borrow from permanent endowment; if those sections permit the complete removal of spending restrictions, they ought also permit a less radical decision to borrow from permanent endowment: see Fig 18 above where we suggest that ss 281 and 282 could be used to convert permanent endowment into expendable endowment. However, ss 281 and 282 are generally used to terminate a permanent endowment fund and we accept that trustees will therefore be reluctant to use them for a less radical purpose; "borrowing" from permanent endowment might be less controversial and therefore more attractive to trustees than "spending" permanent endowment.

<sup>737</sup> If that is something that they would want to do: see n 721 above.



8.127 The power would be available where the charity trustees are satisfied that borrowing would be expedient, which is the same test that the Charity Commission would apply if authorising borrowing under section 105. We would expect trustees to consider the interests of both the charity and the available endowment fund (if different).

8.128 We have included safeguards on the exercise of our recommended statutory power. It would be possible for a borrowing power to apply to the entirety of a permanent endowment fund, just as the section 281 and 282 powers can be used in respect of a charity's entire permanent endowment. The borrowing power, however, is intended to be less radical than sections 281 and 282 (which permit outright spending without recoupment), and is intended to be operated without charities having to obtain Charity Commission approval, so we have concluded that there should be limitations on the scope of the power. Any borrowing in excess of the limits would still need to be authorised by the Charity Commission under section 105 in the usual way. The recommended power incorporates the following safeguards.

- (1) A maximum of 25% of the value of a charity's permanent endowment<sup>738</sup> can be borrowed.
- (2) The repayment period must be not more than 20 years.<sup>739</sup>
- (3) As a minimum charity trustees would be required to repay the sum borrowed, but they may resolve to pay an additional sum (subject to a maximum cap) to reflect the fact that the permanent endowment has not been invested in assets that might have appreciated in capital value; the additional sum would ensure that the real value of the fund was maintained.<sup>740</sup>
- (4) The charity trustees would be required to exercise the power in line with their existing duty of even-handedness; this will guide their decision about how much to borrow, over what period, and whether the real value (or only the amount borrowed) should be repaid.
- (5) The power would only be exercisable where the trustees are satisfied that arrangements are in place for the amount borrowed to be repaid within the permitted 20 years. Trustees may need to obtain advice to ensure that any arrangements are adequate.
- (6) The trustees would be required to seek directions from the Charity Commission if it appears to them that they will not be able to repay the amount borrowed.

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<sup>738</sup> We use the same definition of "available endowment fund": see n 647 above. At the time the charity borrows from the permanent endowment, the total borrowing should not exceed 25% of the value of the fund. Accordingly, if the charity has already borrowed 10% of the value of the fund and then wishes to increase its borrowing, its additional borrowing taken together with the original borrowing should not exceed 25% of the value of the fund.

<sup>739</sup> Both the level of maximum borrowing and the maximum repayment period are capable of amendment by secondary legislation.

<sup>740</sup> The TRI regulations permit trustees to allocate investment returns to the trust for investment subject to an inflation-based cap, with the trustees having flexibility in choosing an appropriate inflation index. A similar mechanism has been incorporated, so that trustees will have to repay somewhere between the actual sum borrowed and the real value of that sum.

- 8.129 We recommend a borrowing limit of 25% of the value of the permanent endowment fund following discussions with members of the CLA and the Charity Commission, amongst whom there was a consensus that 25% was an appropriate figure. Borrowing in excess of 25% would require Charity Commission consent (under the existing power in section 105). We think that allowing borrowing of much more than 25% without Charity Commission oversight might be seen as permitting reckless borrowing (in terms of the consequences of a failure to repay, and the ability of a charity to recoup borrowing using the income from the remaining 75% of the capital). We accept that (as we discuss elsewhere in respect of financial thresholds) there is some arbitrariness in selecting a figure.
- 8.130 The Charity Commission already publishes guidance about applications to borrow permanent endowment and the matters that it will consider under section 105.<sup>741</sup> We anticipate that the Charity Commission would revise that guidance following the introduction of the new power to assist trustees in devising a policy for repayment of the borrowing and in deciding whether and how to obtain advice.
- 8.131 There will be some overlap between this power to borrow and the power to release restrictions on spending permanent endowment under sections 281 and 282. In using this new power trustees would, in effect, be opting to pursue a more restrictive route. However, the new power will be useful in cases where the condition in section 281(4) and 282(3) is not met because the trustees are not satisfied that the fund ought to be freed from the restrictions applicable to it without any requirement to recoup expenditure. It would enable trustees to take a more cautious approach to releasing, temporarily, the restrictions on a portion of the fund in question.
- 8.132 For charities that have opted into total return investment, the power would be available in respect of the charity's trust for investment excluding any unapplied total return. The power would overlap with that in regulation 4 of the TRI Regulations, but would have a wider range of potential uses.
- 8.133 There is no specific monitoring or enforcement regime when the Charity Commission authorises trustees to borrow from permanent endowment under section 105; trustees' existing duties go a long way to ensuring that borrowing from permanent endowment is repaid. Similarly, we do not think that there should be specific enforcement mechanisms in respect of the new power beyond the Charity Commission's existing powers to intervene in the administration of a charity where it has regulatory concerns.
- 8.134 Charities exercising the new power will be required to have a repayment plan in place. They will need to account for their progress as against that repayment plan in whatever form of accounts they are usually required to prepare. We envisage the Charity Commission's guidance and Charity SORP<sup>742</sup> being updated to provide that charities must account for any exercise of the new borrowing power either in their annual report or, if they do not produce one, in their accounts. This would include providing detail of their repayment plan and their compliance with it.

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<sup>741</sup> Charity Commission, *OG545-2 Expenditure and Replacement of Permanent Endowment* (February 2014), available at <http://ogs.charitycommission.gov.uk/g545a002.aspx>.

<sup>742</sup> Charity Commission and Office of the Scottish Charity Regulator, *Statement of Recommended Practice (FRS102)* (effective 1 January 2015) available at <http://www.charitycorp.org/>.

8.135 If the power is used to make a social investment with an uncertain, or negative, financial return, and the social investment performs better than expected, then there will be no losses to be replenished. Conversely, if the social investment performs worse than expected, the losses to be replenished will be greater.

8.136 The power could also be used to engage in a limited form of portfolio offsetting. The loss from a social investment (the borrowing) could simultaneously be repaid by the income from another asset in the portfolio.<sup>743</sup> The power would not, however, allow trustees to engage in full portfolio offsetting since (a) they would be required to repay any actual losses, even if they arose from a fall in market values,<sup>744</sup> and (b) the limitations on the scope of the power<sup>745</sup> would prevent charities from integrating social investments within the entire portfolio. It is that issue to which we turn next.

## **(2) A power to engage in portfolio offsetting**

8.137 Portfolio offsetting involves trustees using permanent endowment to make a social investment with an expected negative financial return, provided that the charity's permanent endowment as a whole is expected to maintain its overall value in the long term. In response to our consultation on Social Investment by Charities,<sup>746</sup> the Association of Charitable Foundations suggested that trustees ought to be able to make individual social investments that may not maintain their capital value if they can anticipate that other assets will provide a sufficient financial return to maintain the overall value of the investment portfolio. It gave the following example of how portfolio offsetting could work in practice:

A permanently endowed charitable foundation exists to support the needs of vulnerable young people in a specific geographical area. Then say a local youth service has been given notice to quit their premises by the freeholder who has offered to sell them the property if they can raise the capital within six months, or else he will sell it to developers. The youth service has existed for some years, though always with some degree of future uncertainty because they rely on voluntary donations, grants and income derived from Government contracts. The building is the only suitable place in the neighbourhood for the youth service and so they approach the foundation asking for a loan with a long-repayment period with which to buy the property. Because of the ongoing uncertainty around the youth service's finances, they cannot access mainstream finances. Indeed the loan would be risky and, in all probability, not maintain the real value of the capital outlay. However the trustees invest under total return and, while they do not immediately have sufficient unapplied total return to make the investment, they are confident that, over time, they could sustain the financial loss on this specific investment while maintaining the real capital value of the portfolio because they anticipate other [asset] classes to make above-inflation returns. They believe that securing the future of the youth service is in the best interests of their charitable objectives but there is not enough time to vary the permanent restrictions on their endowment.

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<sup>743</sup> Under a standard investment approach, borrowing would have to be replenished from income and not capital returns. Under the TRI Regulations, however, the borrowing could be repaid from both income and capital returns, namely the unapplied total return.

<sup>744</sup> See n 721.

<sup>745</sup> See para 8.128.

<sup>746</sup> Social Investment by Charities (2014) Law Commission Consultation Paper No 216.

8.138 We remain of the view that creating a tailor-made power to permit portfolio offsetting would be complicated.<sup>747</sup> But as noted above, some consultees suggested – and we agree – that it could be achieved within the TRI Regulations, which would overcome many of the complexities of creating a tailor-made power.

- (1) The TRI Regulations are well-recognised, tried-and-tested and welcomed by many in the sector.
- (2) Under a standard investment approach, the traditional distinction between capital and income<sup>748</sup> would mean that any capital losses would have to be offset by *capital* gains (or there would have to be a power to accumulate income to replenish capital losses). This problem is already solved by the TRI Regulations which treats all returns (capital and income) in the same way and provides a power to allocate the return to the trust for investment in line with inflation.
- (3) The TRI Regulations provide a framework that incorporates the duty of even-handedness, a duty of care on trustees, a duty to obtain advice, and reporting requirements.
- (4) If trustees were engaged in portfolio offsetting, they would still expect to generate an unapplied total return, albeit it would be less than if they were solely making mainstream investments. Trustees would be able – in conformity with their duty of even-handedness – to allocate the unapplied total return to the trust for investment in line with the cap on inflation so as to preserve the real value of the endowment.

8.139 A power to make social investments with a negative or uncertain financial return within the TRI Regulations would have two further advantages. First, if permanently endowed charities that have already opted in to TRI wish to engage in portfolio offsetting, they are likely to prefer to do so using a tailored power within the regulations, rather than exercising a separate power to borrow. Second, unlike use of the power to borrow, trustees would not be required to replenish actual losses; the power would therefore allow trustees to treat social investments as standard investments within the portfolio.

8.140 Trustees would have a choice as to whether to adopt this power. It would require a further resolution of the trustees. We do not think that it would be appropriate to impose the power on all trustees who have opted in to the TRI regime. The resolution would have the effect of further releasing the restrictions on spending capital, but only for the purposes of making social investments.<sup>749</sup> It would remain the case that most social investments (that is, with an expected positive financial return and which therefore fall within the meaning of “investments”) could be made without having to adopt the new power. The new power would be of assistance to charities wishing to make social investments with a negative (or uncertain) financial return where they expect losses to be covered by gains elsewhere in the portfolio. The new power could be used in the scenario posed by the Association of Charitable Foundations (see paragraph 8.137 above.)

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<sup>747</sup> See n 672.

<sup>748</sup> See para 8.50.

<sup>749</sup> This follows from our conclusion above following the lack of appetite for a more general new regime governing permanent endowment.

8.141 It should be noted that the creation of this new power would necessarily make the TRI Regulations more complicated. In addition, trustees would, in theory, be able to run down the unapplied total return and the trust for investment over time by making a succession of social investments with a negative financial return, but to do so would be a breach of their duty of even-handedness. We think that trustees would therefore exercise the power appropriately.

#### **Distinction between the two recommended powers**

8.142 We are recommending the creation of (1) a power to borrow from permanent endowment and (2) a power to make social investments with an expected negative financial return within the TRI Regulations. The two powers would be useful additions to trustees' existing toolbox in seeking to further their charity's purpose. Although the two powers would overlap to some extent, they are conceptually distinct and achieve different things.

8.143 The first power would:

- (1) allow trustees to borrow from their permanent endowment for any reason in seeking to carry out the charity's purposes;
- (2) permit trustees to make social investments with a negative financial return without having to opt in to TRI, but it would require them to replenish any losses; and
- (3) permit trustees to engage in portfolio offsetting to a limited extent.

8.144 The second power would:

- (1) be limited to social investment; and
- (2) permit charities to engage in portfolio offsetting without having to recoup actual losses – for example in the case of a fall in the market – thereby treating social investments like mainstream financial investments.

#### **Recommendation 24.**

8.145 We recommend that:

- (1) trustees be given a statutory power to borrow from their permanent endowment by allowing them to resolve to spend up to 25% of the value of the permanent endowment subject to a requirement that they recoup that expenditure within 20 years; and
- (2) trustees be given a power, once they have opted into the regulations governing total return investment, to resolve that the permanent endowment restrictions be further released to permit them to make social investments with a negative or uncertain financial return (which would not otherwise be permitted as "investments").

8.146 This recommendation would be given effect by the implementation of:

- (1) clauses 12 and 13 of the draft Bill; and
- (2) the draft amendments to the Charities (Total Return) Regulations 2013, at Appendix 6.

# Chapter 9: Remuneration for the supply of goods and the power to award equitable allowances

## INTRODUCTION

- 9.1 A charity trustee, as a fiduciary, must act with “single-minded loyalty” in the interests of the charity.<sup>750</sup> This concept is normally split into two distinct but overlapping duties that are owed by trustees, namely the duty not to profit by virtue of their position as a trustee, and the duty not to put themselves in a position where their interests and duties conflict.<sup>751</sup> It is a strict rule that a charity trustee, as a fiduciary, must account for (that is to say, hand over to the charity) profits generated by reason of his or her position as charity trustee, or in circumstances involving a conflict between the trustee’s duty to the charity and the trustee’s personal interests.<sup>752</sup> Without more, this would prevent a trustee from being paid, even at a below-market rate, for the provision of (for example) accountancy services, or building materials, to the charity.
- 9.2 The strict rule is qualified in various ways; trustees are not required to account for any profits if the action (which would otherwise amount to a breach of trust) has been authorised in one of four ways.<sup>753</sup>
- (1) Authorisation may be given pursuant to an express term in the charity’s governing document. The governing document may (a) permit specific acts that would otherwise amount to a breach of fiduciary duty,<sup>754</sup> or (b) confer a power on the trustees to pass a resolution authorising a breach of fiduciary duty by one of their number in specified circumstances,<sup>755</sup> subject to the overriding provisions of the Companies Act 2006.<sup>756</sup> A charity may also amend its governing document to

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<sup>750</sup> *Bristol and West Building Society v Mothew* [1998] Ch 1, 15 by Lord Justice Millett.

<sup>751</sup> *Chan v Zacharia* (1984) 154 CLR 178, 198 to 199, by Mr Justice Deane (High Court of Australia).

<sup>752</sup> For a discussion see M Conaglen, “The extent of fiduciary accounting and the importance of authorisation mechanisms” (2011) 70(3) *Cambridge Law Journal* 548.

<sup>753</sup> *Warman International v Dwyer* (1995) 182 CLR 544 (High Court of Australia). This is subject to the rule of equity that a fiduciary is entitled to an allowance for the skill and effort employed in obtaining the unauthorised profit where it would be inequitable for the principal to step in and take the profit without paying for that skill and effort: *Boardman v Phipps* [1964] 1 WLR 993, 1018 (HC); see paras 9.14 and 9.15.

<sup>754</sup> Such as paying a trustee interest on a loan to the charity.

<sup>755</sup> In relation to a charitable company, the charity trustee implicated in the breach, and any other interested charity trustee, will not usually be entitled to vote on the matter, but if they do then their votes will be discounted for the purposes of determining (a) whether any requirement as to the quorum at the meeting at which the matter is considered has been met, and (b) whether the resolution has been passed by a sufficient majority: Companies Act 2006, s 175(6).

<sup>756</sup> Certain transactions set out in ch 4 of Part 10 of the Companies Act 2006 are required to be authorised by a resolution of the members of a company passed at a general meeting. Members’ resolutions approving such transactions are ineffective without the prior written consent of the Charity Commission: Charities Act 2011, s 201.

include a new power, or to widen an existing power, to authorise a breach of fiduciary duty.<sup>757</sup>

- (2) Section 185 of the Charities Act 2011 empowers a charity to pay a trustee, or a person connected with a trustee, for the provision of services to the charity.<sup>758</sup>
- (3) The Charity Commission may give prior authorisation to a transaction that would otherwise involve a breach of fiduciary duty by making an order to that effect under section 105 of the Charities Act 2011.<sup>759</sup> A section 105 order can only be made if the transaction in question would be “expedient in the interests of the charity”.
- (4) The court can prospectively authorise a breach of fiduciary duty by a trustee of a trust.<sup>760</sup> However, this power is used rarely given the Charity Commission’s equivalent power in section 105 of the Charities Act 2011.

9.3 In this chapter we make recommendations to mitigate the strict rule further. We focus on the law regarding (1) the remuneration of charity trustees for the supply of goods, and (2) the power to award equitable allowances to trustees who have carried out work for the charity and obtained an unauthorised benefit (or ought to be remunerated for their work). We aim to enable charities in appropriate situations to remunerate their trustees more easily and efficiently, whilst ensuring that charity trustees are not encouraged to breach their fiduciary duties.

9.4 Under section 185 of the Charities Act 2011, charity trustees can be remunerated for supplying services to their charity, such as building, decorating, accountancy or legal services. There is, however, no equivalent provision for the supply of goods, despite the fact that it can be advantageous for a trustee to supply goods to their charity (for example, the trustee might sell them at cost price). We conclude that section 185 should be extended to allow trustees to be remunerated for the supply of goods.

9.5 When a trustee has obtained a benefit in breach of fiduciary duty, the trustee must account to the charity for that benefit. When that benefit has been obtained in connection with work undertaken by the trustee for the charity, it might be appropriate to pay the trustee for his or her time, skill and effort in carrying out that work, known as an equitable allowance. Similarly, if the trustee has already undertaken work for the charity for which he or she should be paid (but in respect of which payment was not authorised in advance), it might be appropriate to pay the trustee for the work done. The only way that a trustee can obtain an equitable allowance is through the courts. Such an award is very rare, in part due to the time and expense involved in court

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<sup>757</sup> Such amendments will often require the consent of the Charity Commission. See, generally, Ch 4 above.

<sup>758</sup> The Charities Act 2011, s 185, consolidated the Charities Act 1993, ss 73A and 73B, as inserted by the Charities Act 2006, s 36. We discuss s 185 in paras 9.4, 9.6 and 9.8. The provision of services in this context includes the supply of goods in connection with the provision of services: Charities Act 2011, s 187.

<sup>759</sup> The Charities Act 2011, s 105(9) envisages the power to make an order being used for this purpose: “In the case of a charitable company, an order under this section may authorise an act even though it involves a breach of duty imposed on a director of the company under ch 2 of Part 10 of the Companies Act 2006 (general duties of directors)”.

<sup>760</sup> *Holder v Holder* [1968] Ch 353; *Re Drexel Burnham Lambert Pension Plan* [1995] 1 WLR 32.



proceedings. However, requests for equitable allowances come before the Charity Commission and are dealt with by the Commission giving written confirmation that it will not pursue the trustee for an account of profits.<sup>761</sup> This confirmation does not, however, provide finality or certainty as it will not stop someone else (for example, one of the charity's beneficiaries) taking issue with the unauthorised profit. We recommend that the Charity Commission be given the power to award equitable allowances.

## REMUNERATION FOR THE SUPPLY OF GOODS

- 9.6 Remunerating a trustee for the supply of services and goods will usually constitute a breach of a trustee's duty not to profit by virtue of his or her position. Whilst section 185 gives charities a default power to remunerate their trustees (and persons connected to them) for the supply of services, there is no equivalent power for the supply of goods. Therefore, absent an express provision in the charity's governing document or advance authorisation from the Charity Commission, it would be a breach of fiduciary duty for a charity trustee to receive remuneration for the supply of goods to their charity. Requiring a charity to amend its governing document or obtain prior authorisation from the Charity Commission in order to remunerate a trustee can be burdensome and disproportionate to the amount of the proposed remuneration.
- 9.7 The current law therefore gives rise to an anomaly; a charity could pay a trustee to paint the charity's offices (and the trustee could be paid to supply the paint as part of the transaction),<sup>762</sup> but could not pay the same trustee solely to supply the paint.<sup>763</sup> In the Consultation Paper, we agreed with Lord Hodgson that there was no principled reason for this omission;<sup>764</sup> the reasoning behind the creation of the section 185 power, namely that "often a trustee can provide such a service on much more favourable terms than the charity could obtain elsewhere,"<sup>765</sup> applies equally to remuneration for the supply of goods.
- 9.8 We proposed the creation of a default power to remunerate trustees for the supply of goods which would mirror the power in section 185, including the conditions which have to be fulfilled for the remuneration to be authorised.<sup>766</sup> Those conditions are:
- (1) Condition A: The amount of the remuneration is set out in a written agreement between the charity and the provider of the services ("P") and does not exceed what is reasonable in the circumstances.

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<sup>761</sup> And nor will it pursue the charity or the other trustees for not taking action against the trustee. See also Charity Commission, *Ex gratia payments by charities – case studies* (May 2014) p 2, available at <https://www.gov.uk/government/publications/ex-gratia-payments-by-charities-cc7>.

<sup>762</sup> Since remuneration for the supply of goods is permitted where their supply is in connection with the supply of services: Charities Act 2011, s 187.

<sup>763</sup> With thanks to Stone King LLP for this example.

<sup>764</sup> Consultation Paper, paras 10.36 to 10.46; Hodgson Report, Appendix A, para 14.

<sup>765</sup> Cabinet Office Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Not-For-Profit Sector* (September 2002) para 6.45.

<sup>766</sup> Consultation Paper, para 10.47.

- (2) Condition B: The charity trustees are satisfied that it would be in the best interests of the charity for the services to be provided by P on the terms of the agreement.<sup>767</sup>
- (3) Condition C: The agreement does not result in a majority of the trustees of the charity being persons who are:
  - (a) party to an agreement within (1) above;
  - (b) entitled to receive remuneration out of the funds of the charity otherwise than by virtue of such an agreement; or
  - (c) connected with a person falling within (a) or (b) above.
- (4) Condition D: The trusts of the charity do not contain any express provision that prohibits P from receiving the remuneration.<sup>768</sup>

9.9 Consultation revealed unanimous support for this proposal. It was recognised that it is now commonplace for charities to make express provision in their governing documents for trustees to be paid for the supply of goods. The Charity Commission has included such a provision in its model governing documents.<sup>769</sup> Nevertheless, we consider, and consultees agreed, that a default statutory provision authorising remuneration for the supply of goods should be introduced for two reasons.

- (1) It was recognised in consultation that there remain charities that were established before it became standard practice to include a provision authorising remuneration for the supply of goods in governing documents. The means by which charities without such a provision in their governing documents can remunerate trustees for the supply of goods are inadequate and costly. The procedure to amend governing documents can be cumbersome, time-consuming and expensive; it will often be disproportionate to the proposed remuneration, particularly where the charity wishes to sanction a one-off payment rather than regular remuneration. Similarly, gaining authorisation from the Charity Commission, especially given the strain on Charity Commission time and resources, is administratively inconvenient and time-consuming.
- (2) A statutory provision will give charities further guidance and support, and remove any doubt as to the appropriateness of such payments.

9.10 There was no opposition to the power mirroring the provisions in section 185 of the Charities Act 2011, including the same conditions as set out at paragraph 9.8 above. We consider that these conditions should be sufficient to ensure that remuneration remains exceptional.

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<sup>767</sup> The duty of care in the Trustee Act 2000, s 1(1) applies to a charity trustee when making this decision: s 185(5).

<sup>768</sup> Charities Act 2011, s 185(2).

<sup>769</sup> See, for example, Charity Commission, *Model articles of association for a charitable company* (August 2014) cl 7(2)(c) and (3), available at <https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents>.

9.11 In the Consultation Paper, we endorsed the Charity Commission's view that section 185 supplements any existing power in the charity's governing document.<sup>770</sup> In fact, the effect of section 185(3)(b)(i) seems to be that the section 185 power is only available when the proposed remuneration cannot be paid in accordance with an existing power in the charity's governing document. We recommend that section 185 be amended such that, in relation to both the provision of goods and the provision of services, the power should supplement any existing power in the charity's governing document. It will therefore be open to a charity to use either power, even if the express power is the less prescriptive of the two.

**Recommendation 25.**

9.12 We recommend that:

- (1) the power in section 185 of the Charities Act 2011 allowing charities to remunerate trustees for the supply of services should be extended to allow charities to remunerate trustees for the supply of goods; and
- (2) the power should supplement any existing express power in the charity's governing document (whether narrower or wider) to pay the remuneration.

9.13 Clause 32 of the draft Bill would give effect to this recommendation.

## **EQUITABLE ALLOWANCES**

### **When is an equitable allowance awarded?**

9.14 Equitable allowances can be awarded by the court when a fiduciary deserves a payment for his or her skill and effort in carrying out work for a trust. Equitable allowances are awarded under the court's inherent jurisdiction to order the payment of remuneration to a trustee, and the purpose of that jurisdiction is to ensure the good administration of trusts.<sup>771</sup> An equitable allowance can be awarded in two situations.

- (1) When a trustee has already received an unauthorised payment from the charity, for which he or she must otherwise account to the charity. In such cases, the allowance usually takes effect by way of a reduction in the amount that the trustee must pay back, though it is in fact a payment for the trustee's skill and effort.

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<sup>770</sup> Charity Commission, *Trustee expenses and payments* (CC11)(March 2012), section 4.2, available at <https://www.gov.uk/government/publications/trustee-expenses-and-payments-cc11/trustee-expenses-and-payments>. Consultation Paper, paras 10.16 and 10.45.

<sup>771</sup> *Re Duke of Norfolk's Settlement Trust* [1982] Ch 61, at 79; *Re Berkeley Applegate* [1989] Ch 32, at 50 to 51; *Foster v Spencer* [1996] 2 All ER 672; *Gray v Richards Butler* [2001] WTLR 625; *Brudenell-Bruce v Moore* [2014] EWHC 3679 (Ch), [2015] WTLR 373, at [227]; *Re Portman Estate* [2015] EWHC 536 (Ch), [2015] WTLR 871, at [51] and [52]; *Lewin on Trusts* (19th ed 2015), paras 20-240 to 20-247.

- (2) When a trustee has undertaken work for which he or she has not received any remuneration, but where it would be inequitable for the trustee not to be remunerated.

9.15 In the Consultation Paper we summarised some cases in which equitable allowances had been ordered by the courts.<sup>772</sup> Whether an equitable allowance will be awarded, and the amount of any award, will ultimately depend on the circumstances of the case,<sup>773</sup> but case law indicates the principles that guide the exercise of the court's discretion. An equitable allowance will be awarded where "it would be inequitable now for the beneficiaries to step in and take the profit without paying for the skill and labour which has produced it".<sup>774</sup> Various factors will be taken into account, including:

- (1) whether the charity would otherwise have had to pay someone else to do the work carried out by the trustee;<sup>775</sup>
- (2) whether an allowance would encourage trustees to breach their fiduciary duties;<sup>776</sup>
- (3) the level of skill and expertise required by the work;<sup>777</sup>
- (4) whether an allowance would circumvent an express remuneration clause;<sup>778</sup> and
- (5) whether the trustee acted "openly and above board",<sup>779</sup> although an equitable allowance can be awarded even if the trustee's conduct is not beyond reproach.<sup>780</sup>

### **A power for the Charity Commission to award equitable allowances**

9.16 The Charity Commission cannot award an equitable allowance. The Commission has a statutory power to relieve a charity trustee from liability for breach of trust where the trustee has acted honestly and reasonably and ought fairly to be excused from liability,<sup>781</sup> but this power does not enable the Commission to relieve a trustee from

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<sup>772</sup> See paras 10.23 to 10.35 of the Consultation Paper. The case law does not concern charitable trusts, but the same principles would apply.

<sup>773</sup> *Boardman v Phipps* [1965] Ch 992, 1020 to 1021.

<sup>774</sup> *Guinness plc v Saunders* [1990] 2 AC 663, 701, by Lord Goff. A profit for the beneficiaries is not, however, a crucial ingredient; what is necessary is for the trustee's work to have been of benefit to the trust: see, for example, *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32, at 50 to 51; *Gray v Richards Butler* [2001] WTLR 625: "solicitors should be entitled to reasonable payment for work done by them which is of benefit to the estate".

<sup>775</sup> *Boardman v Phipps* [1964] 1 WLR 993, 1018, by Wilberforce J; *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32, at 50 to 51; *Re Duke of Norfolk's Settlement Trust* [1982] Ch 61, at 79.

<sup>776</sup> *Guinness plc v Saunders* [1990] 2 AC 663, 701, by Lord Goff.

<sup>777</sup> *Boardman v Phipps* [1964] 1 WLR 993, 1018, by Wilberforce J; *Foster v Spencer* [1996] 2 All ER 672.

<sup>778</sup> *Guinness plc v Saunders* [1990] 2 AC 663, 691 to 692, by Lord Templeman.

<sup>779</sup> *Boardman v Phipps* [1965] Ch 992, 1020 to 1021, by Lord Denning MR.

<sup>780</sup> *O'Sullivan v Management Agency Ltd* [1985] QB 428; *Badfinger Music v Evans* [2002] EMLR.

<sup>781</sup> Charities Act 2011, s 191.

liability to account for an unauthorised benefit (or to allow a trustee to be remunerated for work already carried out).<sup>782</sup>

- 9.17 Instead, the trustee must go to court or (as the Commission has informed us) rely on a written indication from the Commission that it will not pursue the trustee in respect of the unauthorised benefit, and nor will it pursue the charity and the other trustees for not taking action against the trustee.<sup>783</sup> As we have explained in paragraph 9.5 above, this cannot provide the trustee or charity with finality or certainty since the Charity Commission cannot guarantee that no one else will take issue with the unauthorised benefit. In the Consultation Paper we noted the time, effort and expense involved in going to court to obtain an equitable allowance. We proposed that the Charity Commission should have a statutory power to award equitable allowances in situations where charity trustees must account for a benefit that they have received in breach of fiduciary duty.<sup>784</sup> We said that this would reduce costs and increase certainty for charities and trustees who would no longer have to rely on an indication by the Charity Commission that formal proceedings will not be pursued. In this way the power would improve transparency and clarity in the Charity Commission's dealings with requests for equitable allowances.
- 9.18 Consultation revealed general support for this proposal, and endorsement of the justifications for it, particularly the time and effort involved in going to court. The Charity Commission agreed with our proposal to extend its jurisdiction in this way.
- 9.19 Consultees who opposed the proposal did so owing to a fear that the power would undermine the strict nature of fiduciary duties and encourage trustees to profit in breach of those duties. To an extent, these arguments could be undermined by the fact that the courts can already award equitable allowances. However, claims for equitable allowances are rarely sought by trustees, and this might be because litigation is costly and complex. We acknowledge, therefore, that giving the Charity Commission this power might make claims for an equitable allowance more common given that the procedure will be less burdensome than going to court. We do not, however, think that this would undermine the strict nature of fiduciary duties for two reasons.
- 9.20 First, requests for equitable allowances already come before the Charity Commission, but the current means of resolving them is unsatisfactory because the Charity Commission cannot give certainty as to whether the trustee can retain an unauthorised benefit.<sup>785</sup> Therefore the new power is better conceived as enabling the Charity

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<sup>782</sup> The Charity Commission takes the view that the Charities Act 2011, s 191 only empowers the Commission to relieve a charity trustee from liability to compensate a charity for a loss the charity has suffered by reason of the trustee's breach of duty; it does not extend to relieving a trustee from liability to account for an unauthorised profit: Charity Commission, *OG98 A1 Power of the Commission to relieve trustees, auditors, etc from liability for breach of trust or duty* (March 2012) para 1.4. There is conflicting judicial authority on the point: compare *Sinclair v Sinclair* [2009] EWHC 926 (Ch), at [76], by Proudman J (interpreting the similar s 61 of the Trustee Act 1925) and *Coleman Tymar v Oakes* [2001] 2 BCLC 749, at [82], by HHJ Reid QC (interpreting the similar s 727 of the Companies Act 1985), and see M Conaglen, "The extent of fiduciary accounting and the importance of authorisation mechanisms" (2011) 70(3) *Cambridge Law Journal* 548, n 112.

<sup>783</sup> See also Charity Commission, *Ex gratia payments by charities – case studies* (May 2014) p 2.

<sup>784</sup> Consultation Paper, para 10.59.

<sup>785</sup> See para 9.17 above and Consultation Paper, para 10.54.

Commission to deal better with requests that it is already receiving. Such a power would be consistent with the many other situations where the Charity Commission performs quasi-judicial functions.

- 9.21 Second, we agree that equitable allowances should be regarded as exceptional so as to ensure the strict nature of fiduciary obligations. However, we think that this is given better effect by the test used to decide whether to award them, rather than the procedure by which they are claimed. Limiting the award of equitable allowances by having a long and costly process for claiming might deter meritorious claimants. We therefore view a simpler procedure, with a test which reflects the exceptional nature of equitable allowances,<sup>786</sup> as a better solution, even if it results in a small increase in claims.
- 9.22 It was also suggested in consultation that the new power could result in reputational damage for the Charity Commission as a regulator if it was seen to encourage breaches of fiduciary duty where they are profitable for the charity.<sup>787</sup> We do not think that the new power would have this effect since the Charity Commission would not be condoning the trustee's behaviour, but merely acknowledging that the trustee should be awarded an allowance in respect of his or her time and skill. In any event, the Charity Commission will have a discretion as to whether to exercise the power. It is likely to be exercised only where the trustee accepts liability for breach of fiduciary duty, and the trustee and the charity agree to the retention of some or all of the benefit obtained through the breach (or the benefit proposed to be obtained in relation to the work) by way of an equitable allowance. Where the trustee denies liability for breach of fiduciary duty, or where there is a dispute between the parties as to the trustee's entitlement to an equitable allowance, the Charity Commission is unlikely to exercise the power and the matter would have to be resolved in court proceedings. Therefore, if the power is used properly, reputational damage to the Charity Commission can be prevented.

### **The criteria to be used for awarding equitable allowances**

- 9.23 In the Consultation Paper we suggested two alternatives for the possible criteria that would apply to the exercise of the power to award equitable allowances:
- (1) the criteria used by the courts; or
  - (2) the criteria that apply to the exercise of the power in section 191 of the Charities Act 2011, namely whether the trustee has acted honestly and reasonably and ought fairly to be relieved from liability.
- 9.24 The criteria applied by the courts when considering whether to award an equitable allowance were summarised in paragraph 9.15 above. The test is fairly complex and nuanced. Section 191 of the Charities Act 2011, which empowers the Charity Commission to relieve charity trustees from liability from breach of trust or breach of duty committed in their capacity as a trustee, employs a simpler and more "broad-brush"

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<sup>786</sup> For example, it was noted at para 9.15 above that the current test for awarding equitable allowances takes into account whether awarding an allowance in the circumstances would encourage breaches of fiduciary duty in future.

<sup>787</sup> Charity Commission for Northern Ireland.

test; namely whether the trustee has acted honestly and reasonably and ought fairly to be relieved from liability.<sup>788</sup>

- 9.25 There were mixed responses from consultees as to which test would be preferable. The majority of consultees supported the use of the test in section 191, mostly because that test is simpler than the court test, it is easily understandable and it is familiar to the Charity Commission.<sup>789</sup> Consultees were also concerned about the Charity Commission awarding equitable allowances in situations where the trustee has not acted fairly and reasonably.

#### Conceptual difficulties and the court criteria

- 9.26 Despite these arguments, following consultation we have been convinced that the court test is the appropriate test on which to base the new power to award an equitable allowance.
- 9.27 Professor Duncan Sheehan pointed out that the use of the section 191 test would pose conceptual difficulties since relieving liability and awarding an equitable allowance are different exercises, even if they both involve reducing the sum being paid by the trustee to the charity. Whilst the relief of liability under section 191 is for loss incurred by the charity as a result of a breach of trust, equitable allowances relate to the disgorgement of unauthorised benefits received in breach of fiduciary duty and allow trustees to retain some or all of the benefit as payment for the trustee's skill and effort in carrying out work for the charity.
- 9.28 An equitable allowance is awarded not out of fairness in itself, but as payment for the skill and effort of the trustee. Whether the trustee has acted honestly and reasonably and ought fairly to be relieved from liability therefore is not the correct question. In this way allowing the Charity Commission to award equitable allowances under section 191 would effectively redefine an equitable allowance: the test in section 191 makes no reference to an award for the skill and effort in carrying out work for the charity, and conversely the court test for an equitable allowance does not require the section 191 criteria to be satisfied. For example, a court could award an equitable allowance in a situation where a trustee's conduct was not beyond reproach,<sup>790</sup> whereas the Charity Commission, following a test based on section 191, could not.
- 9.29 We also consider that the concerns about encouraging breach of fiduciary duty<sup>791</sup> might be mitigated if the test was based on the criteria used by the courts. One factor considered by the courts is whether an equitable allowance would encourage future breaches of fiduciary duty.<sup>792</sup>
- 9.30 We therefore recommend that the power should be available where a trustee has done work for the charity, and that it would be inequitable for the trustee not to be

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<sup>788</sup> See para 9.16.

<sup>789</sup> Though the Charity Commission supported the use of the court test.

<sup>790</sup> As in *O'Sullivan v Management Agency Ltd* [1985] QB 428; see paras 10.32 to 10.35 of the Consultation Paper.

<sup>791</sup> See para 9.19 above.

<sup>792</sup> See para 9.15(2) above.

remunerated (or to retain any benefit already paid). The Commission should have regard to certain factors in making that decision, based on the matters considered by the court in deciding whether to award an equitable allowance. One such factor is the existence of any express provision in the charity's governing document concerning remuneration. That was a significant factor for Lord Templeman in *Guinness v Saunders*.<sup>793</sup> The governing documents of most charities will contain provisions prohibiting the remuneration of trustees or setting out the circumstances in which they may be remunerated. The existence of such an express provision would be a relevant consideration for the Charity Commission in exercising the new power, but as one of many considerations, it would not be decisive.

### Challenging decisions to award, or not to award, an equitable allowance

9.31 It is necessary to decide the basis on which a decision of the Charity Commission to award, or not to award, an equitable allowance could be challenged. There are three options:

- (1) the default position (in the absence of any express provision in the draft Bill) would be that those decisions would be capable of challenge by way of judicial review on application to court;
- (2) the decisions could be subject to an *appeal* to the Charity Tribunal, which would involve the Tribunal making the decision afresh;<sup>794</sup>
- (3) the decisions could be subject to a *review* by the Charity Tribunal in which case the Tribunal will decide the challenge by applying the principles that would be applied by the High Court on an application for judicial review.<sup>795</sup>

9.32 The power to award equitable allowances is to be a discretionary power for the Charity Commission to assist charities and trustees and to avoid the need for them to go to court. If the Commission refuses to exercise the power, an application for an equitable allowance could be made to the court.<sup>796</sup> The Charity Commission is best placed to decide whether to exercise the new power and, provided it makes a decision properly,

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<sup>793</sup> See para 9.15(4) above. In that case a committee of the board of directors purported to agree to remunerate one of the directors, when a clause of their articles of association provided that such a decision had to be made by the entire board. Lord Templeman said that the equitable allowance could not be used so as to "usurp the functions conferred on the board by the articles ... Equity has no power to relax its own strict rule further than and inconsistently with the express relaxation contained in the articles of association": [1990] 2 AC 663, at 691 to 692. Lord Goff took a less strict approach, reserving judgment on whether an allowance might ever be awarded in the case of a director of a company: at 701.

<sup>794</sup> Charities Act 2011, s 319(4).

<sup>795</sup> Charities Act 2011, s 321(4). See Ch 15 where we discuss the rights to appeal against, or seek a review of, decisions of the Charity Commission. The Charity Commission also operates a decision review procedure under which a person who is dissatisfied with a decision of the Commission can ask it to review the decision, and such a review will be undertaken by a different member of staff: Charity Commission, *Dissatisfied with one of the Charity Commission's decisions: how can we help you?* (April 2013), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/637599/our\\_guidance\\_on\\_requesting\\_a\\_review.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/637599/our_guidance_on_requesting_a_review.pdf).

<sup>796</sup> Such proceedings would be "charity proceedings" and would therefore require the Commission's consent under s 115, but following our recommendations in Ch 15, we think that the Commission would face a conflict of interest in deciding whether to give consent, so the applicant would be able to seek permission to make the application directly from the court.



it is not appropriate to give another body the opportunity to re-make the Commission's decision. In addition, the Charity Commission should not feel pressurised into awarding an equitable allowance by the prospect of an appeal against its decision; if it has doubts as to whether or not it is appropriate, it should feel able to refuse to exercise the power (in which case the charity or trustee could make a fresh application for an equitable allowance to the court).<sup>797</sup> We therefore do not think that decisions to award, or to refuse to award, an equitable allowance under the new power should be subject to an *appeal* to the Tribunal. Rather, we think that those decisions should be subject to review, either by the Tribunal or by way of judicial review.

- 9.33 In substance, a challenge by way of judicial review is the same as a review by the Tribunal, since the challenge would be decided on the same basis. But there are important practical differences. The challenges are heard in different forums; judicial review involves a two-stage process under which the applicant must first seek permission to seek judicial review; and judicial reviews can involve costs orders against the unsuccessful party, whereas proceedings in the Charity Tribunal do not, in general, involve "costs-shifting".<sup>798</sup>
- 9.34 The Charity Tribunal provides a quick and lower-cost alternative to court proceedings, and it is arguable that the default position should be that challenges to Charity Commission decisions should be heard by the Tribunal rather than the court. A challenge in the Tribunal by way of review would be determined by applying the same principles as a challenge by way of judicial review, but at less expense.
- 9.35 But in deciding which of these three options in paragraph 9.31 to adopt for decisions concerning equitable allowances, we have considered the present means of challenging other decisions of the Charity Commission. There is general inconsistency in the provisions setting out the challenges that can be made to the Charity Tribunal (in Schedule 6 to the Charities Act 2011).<sup>799</sup> The table at Appendix 7 demonstrates some of the inconsistencies. We think that a full reconsideration of Schedule 6 with a view to reform would be beneficial, but it falls outside the terms of reference for this project.<sup>800</sup> It would also depend to some extent on resources, both for the Tribunal in hearing cases, and for the Commission in responding to Tribunal claims. The result of the inconsistency within the Schedule is that whatever basis of challenge for the new discretionary power we select, it will not be consistent either within our other recommendations, or with the means of challenging other decisions under the Charities Act.<sup>801</sup> In the circumstances, we consider the most appropriate approach for us to take is to base our selection on the route of challenge currently available in respect of the most analogous decision the Charity Commission can take. In this way, we avoid exacerbating the internal inconsistency within Schedule 6, even though we cannot remove it.

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<sup>797</sup> See n 796 above.

<sup>798</sup> See para 15.4 below.

<sup>799</sup> A criticism made in the Hodgson Report, paras 7.16 to 7.19.

<sup>800</sup> Sch 6 can be amended by secondary legislation: Charities Act 2011, s 324.

<sup>801</sup> The question of the appropriate means of challenging a Charity Commission decision also arises in Ch 10 (para 10.56 and following) and Ch 14 (para 14.26 and following) below.

- 9.36 The most analogous decision to the grant of an equitable allowance is a decision to relieve a trustee from liability for breach of trust under section 191 of the Charities Act 2011: see paragraph 9.16 above. A decision to exercise that power, or to refuse to exercise that power, cannot be challenged in the Tribunal (whether by way of appeal or review) but must instead be challenged by way of judicial review. We have therefore concluded that, for consistency, the power to award an equitable allowance should also be subject to challenge to the court by way of judicial review. We would encourage the Administrative Court, when hearing such applications for judicial review, to consider transferring them to the Upper Tribunal in cases where it would be desirable for the claim to be heard by the specialist charity judges in the Tribunal.
- 9.37 There are disadvantages to making Charity Commission decisions to award an equitable allowance subject to challenge by way of judicial review, rather than a review by the Tribunal; as referred to above, an application to court will be more complex and have greater cost implications than an application to an expert tribunal. In practice, however, since the new power for the Commission mirrors the court's existing power, a person who disagrees with the Commission's decision not to exercise the power is most likely to apply to the court for an equitable allowance rather than seek to challenge the Commission's decision (whether that challenge is by way of judicial review to the court or a review by the Tribunal).

**Recommendation 26.**

9.38 We recommend that:

- (1) the Charity Commission should have a power to require a charity to remunerate a trustee (or to authorise a trustee to retain a benefit already received) where:
  - (a) the trustee has done work for the charity; and
  - (b) it would be inequitable for the trustee not to be remunerated for that work (or not to retain the benefit received in connection with that work);
- (2) the exercise of that power, and the decision not to exercise the power, should be subject to challenge by way of judicial review.

9.39 Clause 33 of the draft Bill would give effect to this recommendation.

**Recommendation 27.**

9.40 We recommend that the basis on which decisions of the Charity Commission can be challenged, including in particular the rights of challenge to the Charity Tribunal, should be reviewed.

# Chapter 10: Ex gratia payments out of charity funds

## INTRODUCTION

10.1 In this chapter we make recommendations to give charity trustees greater autonomy, subject to appropriate safeguards, to make ex gratia payments out of their charity's funds. An ex gratia payment is a payment out of charity funds that the trustees feel morally obliged to make, but for which there is no legal basis.<sup>802</sup> We give some examples in Figure 19.

### Figure 19: situations in which trustees might wish to make ex gratia payments

- A testator, whose will leaves a legacy to a family member and the remainder of the estate to charity, makes a hand-written amendment to the will increasing the family member's legacy which is ineffective since it does not comply with the requisite formalities.<sup>803</sup>
- A testator whose will leaves the remainder of the estate to charity instructs solicitors to change the will so as to include an additional legacy, but dies before the amendment could be prepared and executed.<sup>804</sup>
- A charity wishes to give an employee on retirement a pension in excess of that to which he or she is contractually entitled.
- On the winding-up of a charity, the trustees wish to make redundancy payments to employees which exceed the payments that would be required by employment law.

10.2 A charity cannot make an ex gratia payment without prior authorisation. The ability of the court or the Attorney General to authorise ex gratia payments was established in

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<sup>802</sup> *Re Snowden* [1970] Ch 700 at 709, by Cross J. An ex gratia payment can either be a waiver of rights to money or property to which the charity is legally entitled but has not yet received, or a payment of money or transfer of property out of the charity's funds. See Charities Act 2011, s 106(2) and Charity Commission, *Ex Gratia Payments by Charities* (CC7) (May 2014) p 2, available at <https://www.gov.uk/government/publications/ex-gratia-payments-by-charities-cc7>. We refer to the guidance as "CC7".

<sup>803</sup> *Re Henderson* [1969] 1 WLR 651, which was heard with *Re Snowden* [1970] Ch 700.

<sup>804</sup> Charity Commission, *Ex gratia payments by charities – case studies* (May 2014) Example 1. These first two situations would be avoided under our provisional proposal to introduce a "dispensing power" for wills: see *Making a Will* (2017) Law Commission Consultation Paper No 231. Such a power would enable a court to recognise a will as valid even though it does not comply with the formality requirements. The power would be exercised by a court when it is proved that a record captures a person's testamentary intentions. Were a dispensing power to be enacted, certain cases covered in Figure 19 could be resolved by the operation of that power rather than by an ex gratia payment.

*Re Snowden*.<sup>805</sup> The Charity Commission has an equivalent jurisdiction by virtue of section 106 of the Charities Act 2011 (“section 106”), which specifies that the Charity Commission can exercise the same power as the Attorney General to authorise an ex gratia payment where the charity trustees “have no power to take the action, but ... in all the circumstances regard themselves as being under a moral obligation to take it”.<sup>806</sup>

- 10.3 In *Re Snowden*, it was emphasised that the power to authorise an ex gratia payment “is not to be exercised lightly or on slender grounds”.<sup>807</sup> The Charity Commission’s guidance states that trustees “must be able to convince the Commission that there are reasonable grounds for them to believe they would be acting immorally by refusing to make the payment”.<sup>808</sup>
- 10.4 Requiring authorisation before ex gratia payments are made is time-consuming and can involve costs which are disproportionate to the value of the payment itself. We recommend that charities should be able to make small<sup>809</sup> ex gratia payments without prior authorisation. We further recommend that, to improve efficiency in charity administration and to ensure the effective use of trustees’ time, trustees should be able to delegate the decision to make an ex gratia payment. We also make recommendations to align the power of statutory charities to make ex gratia payments with that of other charities.

## A POWER TO MAKE SMALL EX GRATIA PAYMENTS

### Should trustees be given a power to make small ex gratia payments without Charity Commission consent?

- 10.5 Charities must obtain Charity Commission authorisation (or that of the court or the Attorney General) before they can make an ex gratia payment. The requirement for prior authorisation can be burdensome and the costs disproportionate in relation to small payments. The Charity Commission’s practice, therefore, is to allow payments

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<sup>805</sup> [1970] Ch 700. Affirmed, more recently, in *Attorney General v Trustees of the British Museum* [2005] EWHC 1089 (Ch), [2005] Ch 397.

<sup>806</sup> Charities Act 2011, s 106(1). There is a general power for the Charity Commission to authorise any proposed action which is “expedient in the interests of the charity” under s 105. In some cases, an ex gratia payment will be expedient in the interests of the charity and could therefore be authorised under that general power (*Re Snowden* [1970] Ch 700, p 709, by Cross J). But s 106 is a specific and tailored power for ex gratia payments alone, without a requirement that payments are expedient in the interests of the charity.

<sup>807</sup> *Re Snowden* [1970] Ch 700, p 710.

<sup>808</sup> CC7, p 4. In Charity Commission, *OG539 Ex gratia payments by charities* (September 2014), available at <http://ogs.charitycommission.gov.uk/g539a001.aspx> (“OG539”), the Charity Commission adds: “If the trustees confirm that they feel under a moral obligation to make the payment, ... it is unlikely that we would refuse to give this consent. ... That said, we must consider the evidence provided to ensure that the trustees’ decision is one which is *within the range of decisions that a reasonable body of trustees might take* and only make our decision once we have done this” (para B5.1, emphasis added). The Commission will usually authorise a payment where “from the case made and the evidence provided ... the trustees’ decision to make the ex gratia payment appears to be one which *a reasonable body of trustees might take* in the circumstances of the case, and the trustees have made a convincing case that they feel a moral obligation to make the payment, backed up by appropriate evidence” (para B5.2, emphasis added). See also CC7, p 3.

<sup>809</sup> We use the word “small” in this chapter to mean ex gratia payments below a certain threshold. We are aware that, under the recommended thresholds at para 10.19 below, a seemingly large payment could fall below the threshold if it is made by a charity with a large income. Therefore “small” should be read as “small relative to the size of the charity’s income”.

below £1,000 to be made without authorisation, though this practice is not sanctioned by statute.<sup>810</sup> In the Consultation Paper we proposed that charities should be able to make *ex gratia* payments below a certain value without Charity Commission authorisation. We considered that a statutory power would give certainty and clarity to trustees by putting the Charity Commission's current practice on a statutory footing, and it could be extended to permit payments of a higher value.<sup>811</sup> A limit on the size of payment that could be made without Charity Commission oversight would provide a safeguard to protect charitable assets.

- 10.6 Our proposal received overwhelming support on consultation. It was recognised that Charity Commission practice reflects what is realistic in charity administration, and that the law should be aligned with that practice. Consultees confirmed our view that the time and cost involved in obtaining authorisation from the Charity Commission are often disproportionate to the value of the payment. The delays in obtaining authorisation can also result in reputational damage for charities as deserving claimants are kept waiting for *ex gratia* payments. A statutory power to allow charities to make small *ex gratia* payments would go a long way to addressing such problems.
- 10.7 Some consultees said that the requirement for authorisation was sometimes used by charities as a way to deflect claims for *ex gratia* payments and they were concerned that deregulation would make it harder for charities to deflect those claims. Whilst we acknowledge that this problem is pertinent, we do not think that it outweighs the case for deregulation. The filter on *ex gratia* claims should be the requirement for a moral obligation, not the time, cost and expense of having to obtain authorisation. Despite the issue being raised by a number of consultees, all but one consultee nevertheless supported the introduction of the proposed power. One consultee supporting the proposed power was the Institute of Legacy Management, which surveyed its members about our proposals.<sup>812</sup> 97% of its respondents supported our proposal, “despite 30% of respondents expecting that the proposal would lead to an increase in the number of *ex gratia* requests and 56% admitting some degree of concern that it would be harder to reject requests”.
- 10.8 In the Consultation Paper, we said that charities should still have the option of asking the Charity Commission for authorisation, even if the proposed payment could be made using the new statutory power.<sup>813</sup> Cancer Research UK and Stone King LLP expressed their agreement; the appropriateness of *ex gratia* payments can sometimes be difficult to assess regardless of their value.<sup>814</sup> We therefore envisaged the Charity Commission continuing to be involved in difficult or borderline cases, even where the payment is below the relevant financial threshold.
- 10.9 Francesca Quint was concerned, however, that the Charity Commission's practice is to refuse to become involved in transactions where a charity has a power to act without

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<sup>810</sup> OG539, para B4.3.

<sup>811</sup> Consultation Paper, paras 11.34 to 11.40.

<sup>812</sup> 77 charities responded to the survey, including “each of the 14 biggest charities by legacy income”.

<sup>813</sup> Consultation Paper, para 11.38.

<sup>814</sup> Cancer Research UK said that “textbook” *ex gratia* payments can be large, and that difficult cases can be small.

Charity Commission involvement.<sup>815</sup> Accordingly, the introduction of a statutory power might effectively remove charities' ability to obtain authorisation for small ex gratia payments from the Charity Commission, and the consequences are greater if – as we recommend below – the current informal threshold of £1,000 is increased.

10.10 We think that it would be helpful for charities to be able to obtain Charity Commission authorisation for a payment below the financial threshold if they wish to do so in difficult or uncertain cases. From our discussions with the Charity Commission, however, it is clear that if charities have a power to act without oversight, the Charity Commission is likely to refuse to exercise its powers to achieve the same result. Nevertheless, we do not think that this practical consequence should prevent the introduction of a statutory power to make small ex gratia payments; the benefits to charities of being able to act alone in respect of all ex gratia payments below the threshold outweigh the disadvantage of losing the ability to obtain additional reassurance from express authorisation in some of those cases.

### **The threshold for making ex gratia payments without Charity Commission consent**

10.11 It is important to note that a financial threshold would not limit the size of ex gratia payment that can be made; rather, it would determine what size ex gratia payment can be made without Charity Commission consent. Larger payments will remain possible, but they will continue to require consent.

10.12 We proposed that the power to make ex gratia payments without authorisation should be limited to small payments, and suggested a monetary threshold of £1,000 or £5,000.<sup>816</sup> That proposal was to ensure that larger payments remain subject to Charity Commission oversight, and that the financial consequences of misunderstanding or abuse of the power would be fairly minor.

Should there be a financial threshold at all?

10.13 Some consultees were not convinced that there should be such a financial threshold. We accept that any financial threshold is inherently arbitrary.<sup>817</sup> Moreover, as Cancer Research UK pointed out, the size of an ex gratia payment has little bearing on whether the trustees feel a moral obligation to make it, and thus whether the payment can properly be made.<sup>818</sup> For this reason, a threshold could be misleading as it focuses on the size of the payment as opposed to the reasons why the payment should be made. Cancer Research UK proposed instead that charities should be able to make ex gratia payments of any value without Charity Commission authorisation, subject to guidance as to the factors to take into account when deciding whether to make such a payment or whether to seek Charity Commission oversight. Similarly, the Institute of Legacy

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<sup>815</sup> For example, the Charity Commission is unwilling to make a *cy-près* scheme to change a charity's purposes if the charity itself can do so under s 275 of the Charities Act 2011.

<sup>816</sup> Consultation Paper, para 11.35 and 11.36.

<sup>817</sup> See paras 3.4, 3.5 and 8.86 above.

<sup>818</sup> See para 10.8 above; for large payments it can be easy to identify a strong moral obligation, and for small payments it can be difficult. The size of the payment might, however, have some bearing on whether a moral obligation exists since making an ex gratia payments necessarily results in the charity having less to spend on its purposes. So if an ex gratia payment would hinder a charity in fulfilling its purposes, the moral obligation to make it might be weaker.

Management favoured “a model where the Charity Commission is available to assist trustees with more challenging requests leaving trustees to make easy decisions irrespective of value”.

10.14 The proposal made by Cancer Research UK and the Institute of Legacy Management is attractive, but it would be complex to devise and apply, and it would be more likely to be misunderstood and, potentially, misused. The Charity Commission already has an informal threshold below which it allows ex gratia payments to be made without authorisation; therefore charities are already used to considering a threshold in the context of ex gratia payments. Further, if there is no threshold, the financial and reputational consequences of payments being made in the wrong circumstances are greater as larger sums would be involved. We think that oversight of whether the moral obligation requirement has been fulfilled should be required in the case of larger sums. We therefore consider that Charity Commission authorisation should be required where the size of the sum involved means that the consequences of a mistaken or inappropriate payment would be particularly detrimental to a charity. These considerations are also relevant to the question of whether the threshold should be proportionate to the charity’s size, which we discuss below.

What should the financial threshold be?

10.15 Most consultees suggested a fixed financial threshold, but some preferred a threshold that was proportional to the size of the charity. The fact that we discussed fixed thresholds (and not proportionate thresholds) in the Consultation Paper is likely to have influenced consultees’ suggestions.<sup>819</sup>

10.16 The value of fixed thresholds suggested by consultees varied widely.<sup>820</sup> Most consultees supported a threshold of either £1,000 or £5,000, but that is probably because those were the figures that we suggested in the Consultation Paper (and £1,000 is the existing informal threshold set by the Charity Commission).<sup>821</sup>

10.17 The advantage of a fixed threshold, which necessarily applies regardless of the size of the charity, is that it is clear and easy for charities to understand and adhere to. Furthermore, we argued above that the size of an ex gratia payment has little bearing on whether there is a moral obligation to make that payment;<sup>822</sup> it is arguable that the size of a charity also bears little relationship to whether a moral obligation exists. Additionally, reputational damage to a charity from making an inappropriate payment applies (to an extent) regardless of the size of the charity.

10.18 A significant number of consultees, however, thought that differences in charity size should be reflected in the threshold below which charities can make ex gratia payments without Charity Commission authorisation. We agree, as we consider that the size of a charity is relevant to the financial damage that would be caused by an inappropriate ex

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<sup>819</sup> Only a few of the consultees who exclusively suggested a fixed threshold of some sort (as opposed to a fixed threshold alongside other suggestions) acknowledged that they had made a choice between a fixed threshold and one proportionate to the charity’s size.

<sup>820</sup> See Analysis of Responses, Ch 11.

<sup>821</sup> See para 11.35 of the Consultation Paper.

<sup>822</sup> See para 10.13 above.

gratia payment. Whilst inappropriate payments over £1,000 could have severe consequences for a small charity, such consequences (and therefore the risk to the charity) are minimal for a much larger charity. Further, a larger charity is more likely to have access to advice as to the appropriateness of an ex gratia payment. We also consider that reputational damage to a charity from an inappropriate payment will depend (to an extent) on the size of the charity. It could even be argued that a larger charity might be more likely to feel a moral obligation in the case of a small payment, because making that payment would have very little effect on the charity's finances. We have concluded that larger charities should be permitted to make larger payments without Charity Commission oversight. Accordingly, whether Charity Commission authorisation is needed should depend on the size of the charity as well as the size of the payment; we therefore think that the financial threshold should be proportionate to charity size.

10.19 Some consultees suggested that a proportional threshold should be set as a specified percentage of the charity's income. However, we think that a threshold based on a percentage of the charity's income would be unnecessarily complicated. It would require charities to calculate their own exact threshold, which would vary from year to year, and every charity would have a slightly different threshold. Moreover, thresholds based on a percentage of a charity's income are unprecedented in the Charities Act 2011. By contrast, different provisions of the Charities Act 2011 do apply to charities depending on the broad categorisation of their income. We recommend framing the financial threshold by reference to the income band of the charity; although such income bands are more arbitrary than a threshold based on a percentage of the charity's income, they will be much easier for charities to apply. Our suggested income bands and the thresholds to which they relate are as follows:

Income	Threshold
Up to £25,000	£1,000
Above £25,000 and up to £250,000	£2,500
Above £250,000 and up to £1 million	£10,000
Above £1 million	£20,000

10.20 These income bands are well known by registered charities since they dictate the charity's reporting and accounting requirements.<sup>823</sup> We think that setting the threshold by reference to the broad categorisation of a charity's income would provide proportionate regulation and oversight of ex gratia payments, whilst remaining

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<sup>823</sup> Charities Act 2011, Part 8. Charities with an income above £25,000 must have their accounts examined by an independent examiner and submit annual reports and accounts to the Commission. Charities with an income above £250,000 must prepare a statement of accounts (whereas smaller charities can, alternatively, prepare a receipts and payments account and a statement of assets and liabilities). Charities with an income above £1 million must have their accounts audited (whereas smaller charities only need an independent examination).



sufficiently simple for charities to apply. We acknowledge that these thresholds will produce some arbitrary results; a charity with an income of £25,000 will be permitted to make an ex gratia payment of up to £1,000 without oversight, whereas a charity with an income of £25,001 will be permitted to make a payment of up to £2,500. But as we discuss in paragraphs 3.4 and 3.5, that is an inevitable consequence of thresholds and it occurs elsewhere in the Charities Act 2011.

10.21 With regard to the maximum payment thresholds that we recommend, we consider that the lowest threshold should reflect the informal threshold already applied by the Charity Commission, and should therefore be £1,000. We also recommend that the upper limit should be £20,000, as we think any inappropriate payment over this level could cause significant reputational damage to a charity, regardless of its size. The thresholds in between (those of £2,500 and £10,000) constitute 1% of the upper limit of the income band.

A limitation on the number of ex gratia payments?

10.22 The threshold that we recommend would apply to each ex gratia payment that trustees wish to make. We have considered whether there is a risk of charities expending a substantial proportion of their income by making a large number of payments each of which is below the threshold for Charity Commission authorisation. Such a risk could be addressed by placing a cap on the overall value or number of payments that can be made in any financial year. But ex gratia payments are rare and sporadic; it would be arbitrary to prevent a payment from being made under the new power simply because another payment happens to have already been made within the same financial year. Alternatively, therefore, the threshold could apply per “event” giving rise to ex gratia claims (for example, the threshold could apply to any ex gratia payment(s) that are made out of a legacy).

10.23 We have concluded, however, that any such restrictions are unnecessary and would result in unwelcome complexity.<sup>824</sup> Given the strict requirements for an ex gratia payment, trustees and claimants are unlikely to be able to “dress up” one claim (that would exceed the threshold) as multiple claims (that individually would not); in that sense, the new power is self-limiting. There is only a problem if trustees could legitimately by-pass the restrictions on making ex gratia payments, but the general duties that apply to trustees in the administration of their charity will already prevent them from making inappropriate ex gratia payments. In summary, trustees should be trusted and remedies are available against those who act in breach of trust. We do not think that there is any need to limit the new power beyond the creation of a financial threshold.

A power to vary the thresholds by secondary legislation

10.24 We proposed that the Secretary of State should have a power to vary the financial thresholds by secondary legislation.<sup>825</sup> This proposal received support from almost all

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<sup>824</sup> For example, it would be necessary to define the single event to which the threshold applied. That might be fairly simple in the case of ex gratia payments that are made in legacy cases, but not in case of (for example) enhanced redundancy payments following a charity merger or enhanced pension contributions when an employee retires.

<sup>825</sup> Akin to the power, under s 285 of the Charities Act 2011, for the Secretary of State to vary the financial thresholds concerning the release of restrictions on spending permanent endowment under s 282.

consultees, subject to general comments about thresholds in the Charities Act 2011 rarely being updated.<sup>826</sup> We think that having such a power in secondary legislation (as opposed to requiring amendment by primary legislation) makes it more likely that the thresholds will be updated.

### Reporting of ex gratia payments

10.25 We agree with some consultees' suggestion that, as a safeguard against misuse of the new power, ex gratia payments should be properly recorded and reported. There are existing requirements in the Statements of Recommended Practice ("SORP") requiring charities to report all ex gratia payments in detail in the charity's accounts.<sup>827</sup>

### The ability to exclude the power to make small ex gratia payments

10.26 We suggested in the Consultation Paper that the new power should be capable of being excluded in a charity's governing document. The governing document of a charity generally defines the scope of the trustees' powers in using that charity's property, and that should particularly be the case for the use of the property otherwise than in the furtherance of the charity's purposes. This proposal received support from consultees on the basis that a charity should have the freedom to determine its own financial affairs. Any express exclusion of the ability of the charity trustees to make ex gratia payments (in the governing documents of existing or future charities) would also exclude the new statutory power to make small ex gratia payments. But it should also be possible for the new statutory power to make small ex gratia payments to be expressly excluded (in the governing documents of existing or future charities); ex gratia payments of any size would then require authorisation from the Charity Commission under section 106 (or the court or the Attorney General).

#### Recommendation 28.

10.27 We recommend:

- (1) the introduction of a new statutory power allowing trustees to make small ex gratia payments without having to obtain the prior authorisation of the Charity Commission, the Attorney General or the court;
- (2) that the statutory power to make ex gratia payments without authorisation should apply to ex gratia payments of up to:
  - (a) £1,000, in the case of a charity with a gross income in its last financial year of up to £25,000;

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<sup>826</sup> See Ch 3.

<sup>827</sup> Charity Commission and Office of the Scottish Charity Regulator, *Statement of Recommended Practice (FRS102)* (effective 1 January 2015), ch 9, available at <http://www.charitySORP.org/>. S 132 of the Charities Act 2011 requires charities to prepare accounts on the "accruals" basis in accordance with the SORP. Under s 133, charities which both (a) are not companies, and (b) have an income of £250,000 or less, have the option of preparing their accounts on a "receipts and payments" basis. The SORP does not apply to charities that opt to prepare accounts on a receipts and payments basis.

- (b) £2,500, in the case of a charity with a gross income in its last financial year of more than £25,000 and up to £250,000;
  - (c) £10,000, in the case of a charity with a gross income in its last financial year of more than £250,000 and up to £1 million; and
  - (d) £20,000, in the case of a charity with a gross income in its last financial year of more than £1 million;
- (3) that those financial thresholds should be capable of amendment by way of secondary legislation; and
- (4) that the statutory power to make small ex gratia payments should be capable of being expressly excluded or limited by a charity's governing document.

10.28 Clause 15 of the draft Bill, would give effect to this recommendation.

## **DELEGATION OF THE DECISION TO MAKE EX GRATIA PAYMENTS**

### **The test for making an ex gratia payment**

10.29 Section 106(1)(b) permits the Charity Commission to exercise the same power as the Attorney General to authorise an ex gratia payment when the charity trustees “regard themselves as being under a moral obligation” to make a payment. This test is entirely subjective as it relies solely on the internal feelings of the charity trustees. It is not therefore compatible with delegation of the decision to make ex gratia payments; it is impossible to delegate the decision of whether the trustees *themselves* consider there to be a moral obligation, since that would require the delegate to get inside the mind of the trustees on a subjective matter. That delegation is not compatible with the test for making an ex gratia payment is recognised by the Charity Commission.<sup>828</sup>

10.30 It is also noteworthy that the test for ex gratia payments does not seem consistent with the requirement for Charity Commission authorisation; it is unclear how the Charity Commission can be expected to assess whether or not a trustee feels morally obliged to make a payment. In reality, the Charity Commission appears to be applying a more objective test than that contained in section 106 (see paragraph 10.3 above), namely can the trustees reasonably be said to have a moral obligation to make the payment?

### **Should it be possible to delegate the decision to make ex gratia payments?**

10.31 In the Consultation Paper we discussed the possibility of trustees being able to delegate the decision to make ex gratia payments. We acknowledged that although delegation is attractive because it entails greater efficiency in charity administration, it is questionable whether decisions of an entirely moral nature, which involve the application of charity funds otherwise than in the furtherance of its purposes, should be capable of being taken by anyone other than the trustees. We invited consultees' view

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<sup>828</sup> OG539, para B4.1.

as to whether delegation should be permitted and, if so, whether it should be subject to any limitations.<sup>829</sup>

- 10.32 Consultation revealed mixed views as to whether delegation was appropriate. We have concluded that trustees should be able to delegate the decision to make ex gratia payments, and make a recommendation accordingly.
- 10.33 Delegation of decisions to make ex gratia payments is already taking place on a large scale, with many larger charities having dedicated legacy teams which make such decisions. This was demonstrated by the response to the Institute of Legacy Management's survey, in which 84% of respondents reported that trustees are not always involved in the decision to make an ex gratia payment. Whilst we acknowledge that a variation between the law and practice is not in itself necessarily a good reason for reforming the law, the fact that delegation is widespread demonstrates that requiring trustees to take the decisions to make ex gratia payments themselves is considered by some (particularly large) charities to be unrealistic.
- 10.34 The requirement for trustees to make the decision themselves is unrealistic because, as consultation revealed, the decisions are often not significant enough to warrant trustee involvement. For larger charities, the sums involved are relatively small, and charity trustees' time could be put to better use, especially since legacy teams are well equipped to deal with ex gratia requests. Cancer Research UK reported that "following a request to determine a £5,000 ex gratia [payment] one of our trustees queried whether there were some missing zeros on the papers". Delegation of decisions is common, and crucial for the effective running of many charities; Lawyers in Charities said that (in other contexts) large charities often delegate decisions to spend up to £500,000.
- 10.35 Moreover, waiting for approval from the trustees can cause delays in the payment being made which, added to the delays associated with gaining Charity Commission authorisation,<sup>830</sup> can cause reputational damage to the charity involved since deserving claimants are kept waiting for the payment.
- 10.36 Consultees who disagreed with delegating decisions to make ex gratia payments said that such decisions were different from other decisions concerning charity finances, as they involve the use of charitable funds otherwise than in furtherance of the charity's purposes and can therefore be controversial. We nevertheless consider that charity trustees should be given the autonomy to decide on, and manage, delegation themselves. Trustees might decide that the special nature of ex gratia payments means that they will not delegate those decisions, but they might decide that other people within the charity are better placed to consider and decide whether an ex gratia payment should be made. Moreover, trustees would establish processes to ensure that decisions were made by appropriate people, as well as policies to guide them in making the decision.
- 10.37 Other disagreement with delegating the decision to make ex gratia payments was based on the fact that delegation would be incompatible with the wording of section 106(1)(b); we consider this a salient point as explained at paragraph 10.29 above. It should be

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<sup>829</sup> Consultation Paper, paras 11.44 to 11.48.

<sup>830</sup> See para 10.6 above.

recalled, however, that the power of authorisation in section 106 is intended to reflect the power of the Attorney General to authorise ex gratia payments which was established in *Re Snowden*.<sup>831</sup> *Snowden* itself does not address the question whether the trustees themselves (as opposed to another officer of the charity) must consider there to be a moral obligation. For the reasons given above, we do not agree that decisions to make ex gratia payments should be limited to trustees.

10.38 We therefore recommend that section 106 should be reframed (and the ex gratia test reformulated at the same time) to provide that charity trustees can make an ex gratia payment where the charity trustees could reasonably be regarded as being under a moral obligation to make that payment. This would allow the decision to make an ex gratia payment to be delegated by the trustees in accordance with the charity's internal governance structure. The test would therefore become more objective than section 106 currently suggests, and at the same time it would be brought into line with the Charity Commission's existing practice.<sup>832</sup> The relevant question would no longer be whether the trustees themselves feel that there is a moral obligation (which is very difficult for the Charity Commission to ascertain), but whether they could reasonably be regarded as being under a moral obligation. This test will make it easier for the Charity Commission to assess whether to authorise a payment.

10.39 Nevertheless, charities might still come to different conclusions in similar circumstances, given that the notion of a "moral obligation" is in itself subjective. Moreover, it must be remembered that charities have a power, not an obligation, to make ex gratia payments; accordingly, even if the trustees could reasonably be regarded as being under a moral obligation to pay a sum, there is no legal obligation to make the payment and no automatic expectation that a payment will be made. For example, even if the trustees could reasonably be regarded as being under a moral obligation to make a payment, it might be decided that a payment should not be made because it would jeopardise the solvency of the charity.

10.40 As noted above, charities should be cautious about making ex gratia payments, since they involve the use of charitable funds for non-charitable purposes. Overall responsibility for the decision to make ex gratia payments (as with any other decision made by a charity) still lies with the charity trustees. It will be for trustees to decide whether they wish to decide all ex gratia payments personally, or whether they wish to delegate the decision to make some or all ex gratia payments.

### **Potential limitations on delegation**

Persons to whom the decision can be delegated

10.41 In the Consultation Paper we asked whether there should be limitations on the person to whom the decision to make an ex gratia payment can be delegated.<sup>833</sup> Again, consultation responses were mixed, with some consultees in favour of delegation to specified officers and others expressing the view that trustees should be able to delegate to whomever they think appropriate.

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<sup>831</sup> [1970] Ch 700.

<sup>832</sup> See 10.30 above.

<sup>833</sup> Consultation Paper, para 11.48(1).

10.42 We have concluded that delegation should not be limited to any specified person. Different people might be best equipped to deal with ex gratia payments, depending on the charity; it could be a sub-committee of trustees, the chief executive, a legacy officer, or another employee. Delegation is best dealt with by the relevant charity's governing document and the general law, as it is for other powers,<sup>834</sup> particularly because charities vary so significantly in size and structure, and therefore a specified individual will not always be the appropriate person to make the decision. As one consultee noted, in the case of a smaller charity, "the normal powers of delegation would be more flexible and enable appropriate arrangements to be made on a case by case basis".<sup>835</sup> For larger charities, whilst some consultees thought that the decision should be delegated to the charity's chief executive, this will not always be appropriate; such a charity might, for example, have a dedicated legacy officer who is better placed to make the decision. Cancer Research UK said that requiring the chief executive's decision would result in unnecessary "hand holding" and it questioned whether it would be "a good use of a Chief Executive's time (particularly in a large charity) to approve decisions to allow a widow to keep a wedding ring".

10.43 We therefore consider that trustees should be permitted to delegate the decision to make ex gratia payments in the same way that they can delegate other decisions within the charity in accordance with the charity's governing document and the general law, thereby allowing the decision to be taken by the most appropriate person in each charity's individual circumstances.

#### The value of payments capable of being delegated

10.44 We also asked consultees whether there should be a limitation on the value of ex gratia payments that could be delegated by trustees. As above, consultation responses were mixed. Some consultees thought that only decisions about small value payments should be capable of being made by someone other than the trustees, and suggested limits such as £1,000 and £5,000, whilst one consultee suggested a higher limit of £25,000. A few consultees thought that this limit should be the same as the threshold above which Charity Commission authorisation is required.<sup>836</sup> However, we do not consider that there should necessarily be alignment here. Charity Commission authorisation would always be required for larger payments and thus safeguards against misuse of charitable funds are already in place. It is unclear why the trustees themselves should be required by law to make the decision that is subsequently subject to Charity Commission oversight. If delegation is properly managed in accordance with the charity's governing documents, then there is no need to place a statutory limit on the financial value of payments that can be delegated by the trustees. The charity can, of course, place financial limits on the value of ex gratia payments that can be authorised without a decision from the trustees, but that would be a matter for the charity's internal governance. And even if trustees decide to delegate the decision to make any ex gratia payment, every payment falling above the threshold for small ex gratia payments (see paragraph 10.27 above) would still require Charity Commission authorisation.

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<sup>834</sup> See para 10.34 to 10.36 above.

<sup>835</sup> Francesca Quint.

<sup>836</sup> See para 10.5 and following above.

10.45 We therefore do not think that there should be any statutory limit on the value of ex gratia payments that are capable of being decided upon by the trustees' delegates.

**Recommendation 29.**

10.46 We recommend that:

- (1) the test for making an ex gratia payment should be reformulated to allow such a payment to be made when the charity trustees could reasonably be regarded as being under a moral obligation to make it, thus allowing for the decision to make an ex gratia payment to be delegated; and
- (2) trustees should be able to delegate decisions to make ex gratia payments of any value to any person.

This recommendation applies when an ex gratia payment is to be made (i) without Charity Commission oversight under the new statutory power to make small payments (in accordance with Recommendation 28 above), and (ii) with Charity Commission oversight under section 106 of the Charities Act 2011.

10.47 Clause 16 of the draft Bill, inserting a new section 106(1) into the Charities Act 2011, and clause 15 of the draft Bill, inserting new section 331A(3), would give effect to this recommendation.

## STATUTORY CHARITIES

10.48 In *Attorney General v Trustees of the British Museum*,<sup>837</sup> it was held that the Attorney General had no power to authorise an ex gratia payment prohibited by statute. In that case, the trustees of the British Museum were incorporated by section 14 of the British Museum Act 1753 which was superseded by the British Museum Act 1963. The effect of section 3(4) of the 1963 Act, which provided that objects vested in the trustees could not be dealt with other than under certain sections of that Act, was that the Attorney General was precluded by statute from authorising an ex gratia payment by the British Museum. This limitation also applies to the Charity Commission's power to authorise ex gratia payments, given that the statutory jurisdiction of the Charity Commission to authorise ex gratia payments under section 106(1) is the same as the jurisdiction of the Attorney General. Where a charity is incorporated or governed by an Act of Parliament, it is therefore likely that it will be impossible to authorise an ex gratia payment, as to do so would contravene a statutory provision providing for permitted dispositions of that charity's assets.

10.49 In the Consultation Paper we proposed that the Attorney General, the court and the Charity Commission should have the power to authorise ex gratia payments by statutory charities.<sup>838</sup> We said that the jurisdiction to authorise ex gratia payments is narrow, and it is unlikely that Parliament intended, when passing Acts to establish or regulate

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<sup>837</sup> See n 804.

<sup>838</sup> Consultation Paper, para 11.50.

statutory charities, to exclude the power. Similarly, we proposed that the new recommended power for charity trustees to make small ex gratia payments without authorisation should also extend to statutory charities. All but one consultee supported these proposals; it was generally agreed that statutory charities should not be treated differently from non-statutory charities. We agree, and do not consider that there is any reason to differentiate between statutory and non-statutory charities in this context – we do not think a charity’s assets should be more protected simply on the basis that the charity is established or governed by an Act of Parliament.

10.50 One consultee disagreed with our proposal.<sup>839</sup> This disagreement was based on the view that Parliament’s intention, when establishing or regulating statutory charities, should be respected. It was argued that we cannot know that Parliament would not have intended to exclude a power to make ex gratia payments when legislating on the disposition of a statutory charity’s assets. As noted above, we consider that it would be extremely unlikely that Parliament would have contemplated the making of ex gratia payments when establishing or regulating statutory charities, especially since such payments are so rare and that the statutes governing statutory charities often pre-date the recognition of the power to authorise ex gratia payments in *Re Snowden*.<sup>840</sup>

**Recommendation 30.**

10.51 We recommend that:

- (1) the Attorney General, the court and the Charity Commission should have the power to authorise ex gratia payments by statutory charities; and
- (2) the power for charity trustees to make small ex gratia payments without Charity Commission approval should be available to statutory charities.

10.52 Clause 16 of the draft Bill, implementing Recommendation 29 above, operates by conferring a stand-alone statutory power on the Charity Commission, court and Attorney General to authorise ex gratia payments. Accordingly, the Charity Commission’s power is no longer parasitic on the Attorney General’s power (as is currently the case under section 106), and the Attorney General no longer needs to rely on the common law. Since the clause creates a statutory power that specifically concerns ex gratia payments, it will be possible to utilise the power in respect of a statutory charity whose governing Act contains a general prohibition on the charity’s assets being used otherwise than for the charity’s purposes. The power will also be capable of use in respect of Royal Charter charities whose governing documents include a similar prohibition on using the charity’s assets otherwise than for the charity’s purposes, since a statute takes precedence over a Charter. Nevertheless, given the existence of the *British Museum* case, and to put the matter beyond doubt in respect of statutory charities, the new section 106(A) (inserted by clause 16(a) of the draft Bill) makes clear

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<sup>839</sup> Charity Commission of Northern Ireland.

<sup>840</sup> [1970] Ch 700.



that the revised section 106(1) power to authorise ex gratia payments is not limited in the way that section 106 currently is.

10.53 Similarly, clause 15 of the draft Bill operates by conferring a stand-alone statutory power on charity trustees to make small ex gratia payments, and will therefore allow statutory charities to make small ex gratia payments even if the governing Act contains a general prohibition on the charity's assets being used otherwise than for the charity's purposes. The same would apply to a Royal Charter charity. Again, however, the new section 331A(5) (inserted by clause 15 of the draft Bill) puts the matter beyond doubt in respect of statutory charities by stating that the existence of such a prohibition of itself should not be treated as an exclusion of the power.

## **FURTHER REFORM SUGGESTED AT CONSULTATION**

### **Parallel reform of section 105 of the Charities Act 2011**

10.54 Section 105 of the Charities Act 2011 allows the Charity Commission to make an order giving prior authorisation to any transaction that would involve a trustee acting outwith their powers if that transaction would be "expedient in the interests of the charity". At consultation, some consultees suggested that reform of section 106 should be accompanied by similar deregulation of section 105, whereby Charity Commission authorisation would only be required for transactions above a certain value.

10.55 We consider that reform should be limited to ex gratia payments under section 106. Although there will be some situations in which a payment could fall under both section 105 and section 106 (namely, where the payment is made by reason of a moral obligation and it is also expedient in the interests of the charity),<sup>841</sup> the reach of section 105 is much broader than section 106. Whilst section 106 is limited by the very narrow moral obligation requirement for ex gratia payments, section 105 applies to any transaction outside the powers of the charity trustees. We believe that, in general, transactions which are not within the trustees' powers or permitted by the charity's governing document (which, in any event, will often already include a power to act in the charity's best interests) should require Charity Commission authorisation, unless a specific tailored exception applies. Section 106 is one such tailored exception in respect of ex gratia payments. We recommend the creation of another tailored exception, to permit charities to borrow from permanent endowment, in Chapter 8.<sup>842</sup> But to give charity trustees a general power to do anything at all outwith their powers or in breach of their fiduciary duties, provided the transaction is below a certain financial limit, would be far-reaching and would risk being misunderstood or abused and undermining public trust and confidence in charities. We do not endorse such an approach, and instead make narrower recommendations for reform to the specific power to make ex gratia payments in section 106.

### **Appeal from a decision made under section 106 of the Charities Act 2011**

10.56 Robert Pearce QC (a barrister) suggested that a decision made by the Charity Commission under section 106 should be subject to challenge before the Charity Tribunal. Currently, where an application has been refused a charity can subsequently

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<sup>841</sup> See n 806 above.

<sup>842</sup> See paras 8.124 to 8.136 above.

seek authorisation to make the payment from the Attorney General.<sup>843</sup> Robert Pearce QC pointed out that this is unsatisfactory as it may be perceived that the Attorney General has already been involved in the case owing to his or her power to direct and supervise the Charity Commission.<sup>844</sup> A charity can also seek judicial review of the decision, but this is often unhelpful given that an application for authorisation under section 106 may be accompanied by an application for authorisation under section 105,<sup>845</sup> and a decision not to sanction proposed action under section 105 (in contrast to section 106) *can* be reviewed by the Charity Tribunal.

10.57 We noted the three potential avenues for challenging Charity Commission decisions in Chapter 10, as well as the inconsistency between the different rights of challenge.<sup>846</sup> It is arguable that decisions to authorise, and decisions not to authorise, actions under sections 105 and 106 should all be subject to review by the Charity Tribunal. We did not, however, consult on such a change to section 105, and we therefore limit our recommendation to section 106.

10.58 In many cases, the possibility of making a second request for authorisation to make an *ex gratia* payment to the Attorney General (if the Commission refuses authorisation) will be a satisfactory substitute for a challenge to the Charity Tribunal. But, as Robert Pearce QC pointed out, that will not always be the case. On balance, we consider that the best option would be to create consistency between the appeal rights under section 105 and 106 given the overlap between those powers.<sup>847</sup> A decision not to exercise the power under section 105 (that is, a decision by the Commission not to sanction proposed action by the trustees) can be reviewed by the Tribunal.<sup>848</sup> Similarly, we think that a decision not to authorise a proposed *ex gratia* payment under section 106 should be capable of review by the Tribunal. In practice, given the possibility of seeking authorisation from the Attorney General, very few challenges would be made to the Tribunal. As with challenges under section 105, we think that the permitted applicants should be the charity trustees or (if the charity is a body corporate) the charity itself.

### **Recommendation 31.**

10.59 We recommend that decisions by the Charity Commission not to authorise an *ex gratia* payment under section 106 should be subject to review by the Charity Tribunal.

10.60 Paragraphs 25 and 26 of Schedule 3 to the draft Bill would give effect to this recommendation.

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<sup>843</sup> Charities Act 2011, s 106(6).

<sup>844</sup> Charities Act 2011, s 106(3),(4) and (5).

<sup>845</sup> For an explanation of this provision, see para 10.54 above.

<sup>846</sup> See paras 9.31 to 9.37 above.

<sup>847</sup> See para 10.55 above.

<sup>848</sup> Charities Act 2011, s 322(2)(e), which provides that the Commission's decision is a reviewable matter, rather than subject to an appeal. For an explanation of the distinction, see Fig 23 in Ch 15.

# Chapter 11: Incorporations, mergers and trust corporation status

## INTRODUCTION

- 11.1 Charities change their organisational form for numerous reasons. An unincorporated charity which has grown over time might benefit from incorporation<sup>849</sup> for convenience when entering into contracts and to limit the liability of the trustees. A charity's purposes might be better served by merging with another charity, for example, to achieve efficiencies of scale or if a charity's resources are too small for it to achieve its purposes effectively.<sup>850</sup> The Charity Commission publishes guidance<sup>851</sup> for charities wishing to collaborate or formally merge with other charities.
- 11.2 An incorporation or merger involves the transfer of one charity's activities to another. It might include the transfer of a charity's employees, contracts, assets and liabilities. No two incorporations or mergers are the same. They will each raise different legal, accounting and practical issues. Some will be complicated, time-consuming and expensive, something which law reform cannot prevent. The law should, however, facilitate incorporation and merger, and legal obstacles that exist should be removed where possible.<sup>852</sup> We would emphasise that we are not seeking to influence or encourage charities to incorporate or merge, but to improve the legal rules that apply when charities have decided to do so.

### Structure and summary of this chapter

- 11.3 Our discussion in this chapter covers, first, the powers of charities to incorporate and to merge, and second, the mechanisms by which charities can incorporate or merge. For each, we summarise the current law and then consider some of the problems that arise,<sup>853</sup> making recommendations for reform. We then discuss two specific problems which arise in the context of incorporations and mergers: (1) the problem of "shell" charities being retained on the register of charities following incorporation or merger;<sup>854</sup> and (2) the availability of trust corporation status.

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<sup>849</sup> For example, as a charitable company or a CIO; see paras 2.4 and 2.5 above.

<sup>850</sup> The recently published Charity Governance Code recommends that trustees "consider the benefits and risks of partnership working, merger or dissolution if other organisations are seen to be fulfilling similar charitable purposes more effectively and/or if the charity's viability is uncertain": see <https://www.charitygovernancecode.org/en/1-organisational-purpose>, para 1.5.2.

<sup>851</sup> Charity Commission, *Collaborative Working and Mergers* (CC34) (November 2009) available at <https://www.gov.uk/government/publications/collaborative-working-and-mergers-an-introduction-cc34>.

<sup>852</sup> A recent analysis of voluntary sector mergers found that many more charities go into liquidation rather than opting to merge: Eastside Primetimers, *2015/16 The Good Merger Index* (November 2016), available at <https://ep-uk.org/publications/charity-mergers-good-merger-index/>.

<sup>853</sup> The Hodgson Report highlighted some of the difficulties that we address in this chapter: paras 10.1 to 10.8, and Appendix A, paras 16 and 17.

<sup>854</sup> Shell charities are the original charities that cease to operate after incorporation or merger but are kept on the register for practical reasons. See paras 11.82 to 11.84 below.

11.4 Trust corporation status is one of the two issues on which we invited consultees' views in our Supplementary Consultation Paper. The responses revealed problems extending beyond the mergers and incorporations context. The benefit of our final recommendation concerning trust corporation status will generally apply in the context of mergers and incorporations, but it does have more general application.

## THE CURRENT LAW

### Incorporation

11.5 If the trustees of an unincorporated charity wish to operate as an corporate charity,<sup>855</sup> they must establish a corporate body, which will generally be a charitable company or CIO, and transfer the charity's operations to the new corporate body.

### Merger

11.6 If a charity wishes to merge with another charity, it must transfer its operations to the merged charity. A merger is usually structured in one of two ways.<sup>856</sup>

- (1) Charity A transfers its assets to Charity B. Charity A will either be dissolved or remain as a shell charity. Charity B might decide to change its name or to amend its governing document following the merger, but it need not do so.<sup>857</sup> We refer to this as a "Type 1 merger".
- (2) Charity A and Charity B transfer their assets to a new charity, Charity C. Charities A and B will either be dissolved or remain as shell charities.<sup>858</sup> We refer to this as a "Type 2 merger".

Incorporation as a form of merger

11.7 An unincorporated charity that becomes a corporate charity transfers its assets to a new (corporate) charity. Charity incorporation, therefore, is an example of a Type 1 merger. Unless we refer specifically to incorporation and mergers separately, references in this chapter to a "merger" include an incorporation.

### Transferring operations

11.8 We have referred above to a charity transferring its operations to the merged charity. A charity will want to transfer, for example, the charity's staff, contracts, assets and liabilities. In addition, on an incorporation, the charity trustees will generally seek indemnities from the corporate body in respect of any liabilities they had personally incurred on behalf of the charity. Had the charity's assets remained vested in the trustees as an unincorporated charity, the trustees would have had the benefit of their right to indemnity from those assets for the charity's liabilities.<sup>859</sup> The trustees will no

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<sup>855</sup> We are not here referring to the incorporation of charity trustees under Part 12 of the Charities Act 2011.

<sup>856</sup> Based on J Warburton, *The University of Liverpool Charity Law Unit – Mergers: A Legal Good Practice Guide* (January 2001) para 9, available at <http://www.liv.ac.uk/media/livacuk/law/cplu/mergersrep.pdf>.

<sup>857</sup> As a further alternative, Charity B might become a corporate trustee of Charity A.

<sup>858</sup> As a further alternative, Charities A and B might become subsidiaries of Charity C, a holding company.

<sup>859</sup> See para 12.16 below.

longer have access to those assets when they are transferred to the corporate body, so the corporate body should provide them with an indemnity in respect of those liabilities.

### The register of mergers

11.9 The Charities Act 2006 established the register of mergers, which is maintained by the Charity Commission. Registration of a merger gives rise to two consequences. First, it allows “vesting declarations” to be made under section 310, which are intended to effect the transfer of property on merger more efficiently. Second, it makes provision for a gift left by will to a charity that has merged to take effect as a gift to the merged charity. We consider both issues below.

11.10 Registration of a merger is only possible if the merger is a “relevant charity merger”, namely:

- (1) a merger where one charity transfers all of its property to another charity (or charities) and the original charity ceases to exist (or is to cease to exist after the transfer of its property) (which is an example of a Type 1 merger); or
- (2) a merger where two or more charities transfer all of their property to a new charity and the original charities cease to exist (or are to cease to exist after the transfer of their property) (which is an example of a Type 2 merger).<sup>860</sup>

11.11 The meaning of “relevant charity merger” is modified in the case of a merger which involves the transfer of permanent endowment and the trusts on which the permanent endowment is held do not make provision for the termination of the charity.<sup>861</sup> In such a case, references to the property of a charity are to its unrestricted funds only and there is no requirement for the charity to cease to exist.<sup>862</sup> The effect of this modification is that a merger can still fall within the definition of “relevant charity merger” if the original charity’s permanent endowment remains in existence as the original (or a separate) charity.<sup>863</sup> That will frequently be the case on incorporation; unrestricted funds will be transferred to and held by the charitable company or CIO as corporate property, but the permanent endowment will continue to be held on trust (and treated as a separate charity), with the corporate charity becoming the sole trustee of the permanent endowment.

11.12 The definition of “relevant charity merger” does not cover all types of merger. The original charity (or charities) must cease to exist before a merger can be a “relevant charity merger”, so the definition does not include mergers where a shell charity is retained (unless the original charity holds permanent endowment). The advantages of registering a merger were limited to relevant charity mergers in order to discourage the retention of shell charities, which gives rise to administrative costs both for charities and the Charity Commission.<sup>864</sup>

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<sup>860</sup> Charities Act 2011, s 306(1).

<sup>861</sup> We discuss permanent endowment in Ch 8.

<sup>862</sup> Charities Act 2011, s 306(2) and (3).

<sup>863</sup> See para 12.34 below.

<sup>864</sup> We discuss shell charities in more detail at paras 11.82 to 11.84 below.

## Powers to merge

11.13 The trustees need legal authority to merge (whether converting to an corporate charity, or merging with another). That authority may come from an express power in the charity's governing document, from statute, or from a Charity Commission scheme. Alternatively, consultees pointed out that charities can sometimes merge simply by transferring their assets to another charity with similar purposes as an application of their funds in pursuit of their charitable purposes.<sup>865</sup>

### (1) Express powers

11.14 The trustees' powers to transfer the charity's assets to another charity will depend on the terms of the governing document; it might cater for the possibility of merger or, if not, it is likely to contain a dissolution clause.<sup>866</sup>

11.15 A charitable company or CIO could exercise its power of amendment to introduce a power to merge into its governing document.<sup>867</sup> We explain in Chapter 4 our view that such an amendment would not be a regulated alteration (requiring Charity Commission consent) since it does not change how the charity's property is directed in the event of dissolution.<sup>868</sup>

11.16 If the governing document of an unincorporated charity makes no provision for merger, consultation revealed uncertainty as to whether section 280 of the Charities Act 2011 can be used to introduce provisions to permit merger.<sup>869</sup> There is some concern about whether a power to merge can be introduced if it would have the effect of defeating an express dissolution clause.<sup>870</sup>

### (2) Statutory powers

11.17 If the trustees' powers under the governing document are insufficient, the trustees might be able to use statutory powers to carry out a proposed merger instead. Section 268 of the Charities Act 2011 permits the trustees of an unincorporated charity to resolve that all of the charity's property should be transferred to another charity or charities.<sup>871</sup> The purpose behind section 268 is both to facilitate incorporations and to allow small charities to transfer their assets to another charity before winding up. In order to use this power, the following conditions must be satisfied:

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<sup>865</sup> Anthony Collins Solicitors LLP; and Bates Wells Braithwaite.

<sup>866</sup> See for example Charity Commission, *Model trust deed for a charitable trust* (November 2013) cl 32.

<sup>867</sup> See Ch 4, where we discuss the powers of charitable companies and CIOs to amend their governing documents.

<sup>868</sup> Paras 4.18 and 4.19 above.

<sup>869</sup> We discuss s 280 of the Charities Act 2011 in paras 4.32 to 4.35.

<sup>870</sup> The Charity Commission's guidance states that s 280 cannot be used to change the purposes for which a charity's property can be used on dissolution: Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2017) para B5.3.

<sup>871</sup> The power is limited to trustees of unincorporated charities by Charities Act 2011, s 267(1)(c). Accordingly, s 268 can be used to transfer assets to an existing charity (whether incorporated or unincorporated) under a Type 1 merger, and to transfer assets to a new charity (whether incorporated or unincorporated) as a Type 2 merger.

- (1) the charity's annual income must not exceed £10,000, unless the transfer is to a CIO in which case there is no financial limit;<sup>872</sup>
- (2) the charity must not have any "designated land";<sup>873</sup>
- (3) the trustees must be satisfied that the transfer is expedient in the interests of furthering the purposes for which the property is held;<sup>874</sup>
- (4) the trustees must be satisfied that one or more purposes of the transferee is "substantially similar" to one or more of the charity's purposes;<sup>875</sup> and
- (5) the resolution must be passed by at least two-thirds of the trustees who vote.<sup>876</sup>

11.18 Once the resolution has been passed, it must be sent to the Charity Commission with a statement of the trustees' reasons for passing it.<sup>877</sup> On receipt of the resolution, the Charity Commission has a discretion to require the trustees to give public notice of the resolution, and the Commission must consider any comments made by persons "interested in the charity" within 28 days of public notice being given.<sup>878</sup> The Commission can also direct the trustees to provide further information about the resolution.<sup>879</sup>

11.19 The resolution will take effect 60 days after it is received by the Charity Commission, unless the Commission notifies the trustees within that period that it objects to the resolution.<sup>880</sup> Once the resolution takes effect, the trustees must arrange for the property to be transferred to the new charity.<sup>881</sup> The new charity must secure, so far as is reasonably practicable, that the property is applied for such of its purposes as are substantially similar to those of the transferor charity, unless compliance would not result in a suitable and effective method of applying the property.<sup>882</sup>

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<sup>872</sup> Charities Act 2011, s 267(1)(a) and (2).

<sup>873</sup> Charities Act 2011, s 267(1)(b). For the meaning of "designated land", see para 7.25 above.

<sup>874</sup> Charities Act 2011, s 268(3)(a).

<sup>875</sup> Charities Act 2011, s 268(3)(b).

<sup>876</sup> Charities Act 2011, s 268(4).

<sup>877</sup> Charities Act 2011, s 268(5).

<sup>878</sup> Charities Act 2011, s 269(1).

<sup>879</sup> Charities Act 2011, s 269(2).

<sup>880</sup> Charities Act 2011, ss 270 and 271(1). The 60-day period is extended where the Commission requires public notice to be given or requires further information from the trustees: s 271(1)(b), (4) and (5). The resolution is deemed never to have been passed if the 60-day period is suspended for more than 120 days: s 271(6) and (7).

<sup>881</sup> Charities Act 2011, s 272(2).

<sup>882</sup> Charities Act 2011, s 272(2)(a) and (3).

11.20 Where property to be transferred pursuant to a resolution under section 268 is permanent endowment,<sup>883</sup> special provisions apply:

- (1) the trustees must be satisfied that the purposes of the transferee are “substantially similar” to all of the charity’s purposes;<sup>884</sup> and
- (2) the property must be transferred to the new charity subject to the permanent endowment restrictions.<sup>885</sup>

(3) Charity Commission scheme

11.21 If the trustees have no power to transfer the charity’s property to a new corporate body, whether under the governing document or under section 268, they can instead seek from the Charity Commission a scheme authorising the transfer.<sup>886</sup>

(4) Application of funds

11.22 Charities can sometimes merge simply by transferring their assets to another charity with similar purposes as an application of their funds in pursuit of their charitable purposes.

CIOs

11.23 There are separate statutory provisions governing the merger of CIOs. A CIO is permitted by section 240 of the Charities Act 2011 to transfer its operations to another CIO with the consent of the Charity Commission (a Type 1 merger).<sup>887</sup> Two or more CIOs are permitted by section 235 of the Charities Act 2011 to amalgamate and form a new CIO with the consent of the Charity Commission (a Type 2 merger).<sup>888</sup> Both procedures are similar to those under section 268 applying to unincorporated charities.

The purposes of the merged charity

11.24 A proposed merger may raise concerns about the expansion of, or change to, a charity’s purposes, as where, for example, a charity that assists homeless people in Birmingham wishes to merge with a charity that assists homeless people nationally. The statutory powers to transfer property under section 268 are fairly broad; it is only necessary that the transferor and transferee charities have one similar purpose (save in respect of

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<sup>883</sup> Because there are restrictions on its expenditure; see Ch 8.

<sup>884</sup> Charities Act 2011, s 274(3). Where the transfer is to two or more charities, the trustees must be satisfied that (a) the purposes of the transferees, taken together, are substantially similar to all of the purposes of the transferor charity, and (b) the purposes of each transferee are substantially similar to one or more of the purposes of the transferor charity. Compare the condition for the transfer of unrestricted property: para 11.17(4) above.

<sup>885</sup> Charities Act 2011, s 272(2)(b); see Ch 8.

<sup>886</sup> See para 4.37 above on administrative schemes of the Charity Commission. We recommend in para 4.23(3) that statute should make clear that the Charity Commission has power to make schemes in respect of charitable companies and CIOs.

<sup>887</sup> The procedure is set out in Charities Act 2011, ss 240 to 243.

<sup>888</sup> The procedure is set out in Charities Act 2011, ss 235 to 238.



permanent endowment), but the merged charity is under a duty to seek to apply the property to the original charity's purposes.<sup>889</sup>

11.25 If a charity wishing to merge is faced with difficulties concerning its limited purposes, it might decide to change its purposes before merging. A charity's purposes can be changed in accordance with the express terms of its governing document, under statutory powers, or by way of a Charity Commission cy-près scheme. We make recommendations to reform the way that charities can change their purposes in Chapter 4.

### **Mechanisms to effect a merger**

11.26 We said above that, on merger, a charity will want to transfer its staff, contracts, assets and liabilities. In addition, on incorporation, the outgoing trustees will generally also seek indemnities from the new corporate charity. Bespoke arrangements are likely to be required. For example:

- (1) there will be contractual agreements between the original charity (or the trustees) and the new charity;
- (2) ownership of many assets can be transferred by a simple deed, and registered freehold and leasehold estates in land can be transferred by the execution of a HM Land Registry TR1 form;<sup>890</sup>
- (3) the charities will have to negotiate with third parties in order to transfer ongoing contracts;
- (4) the charities might need to obtain third party consents before transferring assets (for example, the transfer of land subject to a mortgage is likely to require the consent of a mortgagee, and the assignment of a lease containing covenants against assignment requires the consent of the landlord);<sup>891</sup> and
- (5) where trustees hold permanent endowment, they are likely to transfer legal title to the new charity so that the new charity becomes the sole trustee of the permanent endowment.

11.27 In some cases, transferring operations on merger will be simple. Other cases will be complex and administratively burdensome. The Charities Act 2011 provides some mechanisms that are intended to assist the transfer of assets (and sometimes rights and liabilities) which are described below.

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<sup>889</sup> See para 11.19.

<sup>890</sup> A transfer of assets to a charitable company on incorporation or merger might amount to a substantial property transaction under s 190 of the Companies Act 2006 and therefore require the Charity Commission's consent under s 201 of the Charities Act 2011.

<sup>891</sup> Leases often contain a covenant against assignment (or sub-letting, parting with possession and sharing occupation). Such covenants are generally "absolute" (such that assignment is prohibited) or "qualified" (such that assignment is prohibited without the landlord's consent, usually subject to a proviso that consent is not to be unreasonably withheld).

(1) Charity Commission vesting orders: section 272 of the Charities Act 2011

11.28 When an unincorporated charity resolves to transfer all of its assets to another charity under section 268 (on incorporation or merger), the legislation anticipates that the trustees will execute the necessary documentation to effect the transfer.<sup>892</sup> However, the Charity Commission has a power, at the request of the trustees, to make an order vesting property in the transferee charity.<sup>893</sup> The power is unlimited in scope. It would be possible for the power to be used to transfer a lease to the new charity without obtaining the landlord's consent, despite the existence of a covenant against assignment. Such a transfer either would not amount to an assignment,<sup>894</sup> or would be protected by section 286.<sup>895</sup>

(2) Pre-merger vesting declarations: section 310 of the Charities Act 2011

11.29 Pre-merger vesting declarations were introduced, together with the register of mergers, by the Charities Act 2006. They were intended to provide a simpler means of transferring property to the transferee charity on merger or incorporation.<sup>896</sup> The trustees of the original charity make a declaration by deed that, from a specified date, all the charity's property is to vest in the transferee.<sup>897</sup> The declaration can only be made in respect of a "relevant charity merger", so the original charity must cease to exist once all of its property has been transferred to the merged charity (unless the charity holds permanent endowment).

11.30 A section 310 vesting declaration operates to vest the legal title to all of the transferor's property in the transferee, without the need for any further document transferring it.<sup>898</sup> A section 310 vesting declaration does not, however, apply to:

- (1) "any land held by the transferor as security for money subject to the trusts of the transferor (other than land held on trust for securing debentures or debenture stock)" ("the first exception");
- (2) "any land held by the transferor under a lease or agreement which contains any covenant (however described) against assignment of the transferor's interest without the consent of some other person, unless that consent has been obtained before the specified date" ("the second exception"); or

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<sup>892</sup> Charities Act 2011, s 272(2): "The charity trustees must arrange for all the property ... to be transferred in accordance with the resolution".

<sup>893</sup> Charities Act 2011, s 272(4). The Charity Commission states that it will rarely use this power: Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2014) para B2.5.

<sup>894</sup> By analogy with vesting orders made by the court, which do not infringe covenants against assignment: *Marsh v Gilbert* [1980] 258 EG 715; *Woodfall: Landlord and Tenant* (August 2017) para 11.166.

<sup>895</sup> S 286 provides: "No vesting or transfer of any property in pursuance of any provision of this Part [which includes section 272] operates as a breach of a covenant against alienation or gives rise to a forfeiture."

<sup>896</sup> Cabinet Office Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Not-For-Profit Sector* (September 2002) para 4.59 and following.

<sup>897</sup> Charities Act 2011, s 310(1).

<sup>898</sup> Charities Act 2011, s 310(2).

- (3) “any shares, stock, annuity or other property which is only transferable in books kept by a company or other body or in a manner directed by or under any enactment” (“the third exception”).<sup>899</sup>

11.31 These exceptions are modelled on those in section 40 of the Trustee Act 1925, which provides for the automatic transfer of trust property when the trustees change.

11.32 A section 310 vesting declaration:

- (1) does not override the requirement that a transfer of land be registered;<sup>900</sup> and
- (2) does not apply to a charity’s permanent endowment.<sup>901</sup>

11.33 By section 313, no vesting or transfer of any property under section 310 operates as a breach of covenant or condition against alienation or gives rise to a forfeiture.

11.34 Where the transferee is a CIO, the effect of section 310 vesting declarations is modified in three respects by regulation 61 of the Charitable Incorporated Organisations (General) Regulations 2012<sup>902</sup> (the “CIO General Regulations”).

- (1) Section 310 vesting declarations do apply to a charity’s permanent endowment.<sup>903</sup>
- (2) Section 310 vesting declarations might permit minor modification to the permanent endowment restrictions (and special trust restrictions) since they are to be held “on the same trusts, so far as is reasonably practicable, on which the property was held immediately before the merger”.<sup>904</sup>
- (3) When the CIO holds permanent endowment or special trust property as trustee following a section 310 vesting declaration, it is to be treated<sup>905</sup> as if it were a trust corporation appointed by the court to be a trustee.<sup>906</sup>

11.35 Section 310 does not confer on charities a power to merge; rather, a section 310 vesting declaration is a mechanism to effect the transfer of assets in the case of a relevant

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<sup>899</sup> Charities Act 2011, s 310(3).

<sup>900</sup> Charities Act 2011, s 310(4). HM Land Registry would investigate the declaration before registering the new trustees as proprietors of the land. By analogy with the equivalent provision in the Trustee Act 1925, it has been suggested that it is more expedient for the original trustees simply to execute a TR1 form in favour of the new trustees; *Halsbury’s Laws of England Vol 98* (5th ed 2013) para 308; *Ruoff and Roper: Registered Conveyancing* (August 2017) para 37.011.

<sup>901</sup> Charities Act 2011, s 312(1)(b).

<sup>902</sup> SI 2012 No 3012, reg 61.

<sup>903</sup> CIO General Regulations 2012, reg 61(2). Reg 61(2) also expressly includes property held on special trust (which is not also permanent endowment). As we explain in para 11.60 below, that gives rise to uncertainties as to whether section 310 vesting declarations apply to special trust property where the transferee is not a CIO, so reg 61 does not apply.

<sup>904</sup> CIO General Regulations 2012, reg 61(2)(b)(ii) (emphasis added). Bates Wells Braithwaite said that the extent to which these words permit permanent endowment restrictions to be changed is unclear.

<sup>905</sup> For specified purposes, set out in Charities Act 2011, sch 7, para 3.

<sup>906</sup> CIO General Regulations 2012, reg 61(4). We discuss trust corporations in para 11.105 and following below.

charity merger, and it relies on the charity having a power to merge (see paragraphs 11.13 to 11.22 above). Some consultees said that problems had been caused in practice by the Charity Commission suggesting that a scheme was unnecessary because section 310 gave trustees a power to merge. We agree with those consultees that the availability of a section 310 vesting declaration is parasitic on the charity having a power to merge.

11.36 A number of consultees were critical of section 310 vesting declarations and we discuss these criticisms in paragraphs 11.51 to 11.60 below ahead of making recommendations for reform.

(3) Automatic vesting for CIOs: sections 239 and 244 of the Charities Act 2011

11.37 The power to make a vesting declaration under section 310 does not apply when the charity transferring its property is a CIO. When a transfer by a CIO to another CIO is approved by the Charity Commission: “all the property, rights and liabilities of the transferor CIO become by virtue of this subsection the property, rights and liabilities of the transferee CIO in accordance with the resolution.”<sup>907</sup> And when the amalgamation of two or more CIOs is approved by the Charity Commission registering the new CIO: “all the property, rights and liabilities of each of the old CIOs become by virtue of this subsection the property, rights and liabilities of the new CIO.”<sup>908</sup>

11.38 Unlike section 310 vesting declarations, no property is expressed to be excluded from these automatic deeming provisions. By section 250 of the Charities Act 2011, no vesting or transfer of property under these provisions operates as a breach of a covenant or condition against alienation or gives rise to a forfeiture.

(4) Vesting by a Charity Commission scheme or order

11.39 Where trustees cannot transfer property on merger, they can ask the Charity Commission to make a scheme to effect the transfer. We have heard that the Charity Commission has also effected transfers of property on merger using its power under section 105 of the Charities Act 2011 to sanction by order any action that would be expedient in the interests of the charity.<sup>909</sup>

11.40 Unlike section 310 vesting declarations, no property is expressed to be excluded from these powers.

### **Permanent endowment and special trust property**

11.41 As can be seen from our discussion above, permanent endowment and special trust property is given tailored treatment when charities merge. If an unincorporated charity wishes to incorporate but holds property which is permanent endowment, it is widely

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<sup>907</sup> Charities Act 2011, s 244(1)(b).

<sup>908</sup> Charities Act 2011, s 239(2).

<sup>909</sup> Bates Wells Braithwaite, *BWB submission to Lord Hodgson on the property aspects of the Charities Act 2006* (September 2012), available at <http://www.bwbllp.com/file/submissiontothepublicadministrationselectcommitteedoc-v1-pdf>. A transfer by scheme under s 69, or by order under s 105, would enjoy the protection of s 116, which provides that “no vesting or transfer of any property in pursuance of any provision of this Part operates as a breach of a covenant or condition against alienation or gives rise to a forfeiture”. Further, such vesting of property might not amount to a breach of covenant against assignment at all: see n 894 above.

believed that the permanent endowment cannot be acquired as corporate property of the company,<sup>910</sup> but rather must continue to be held on trust.

11.42 We concluded in Chapter 8 that property that falls within the definition of permanent endowment in section 353 of the Charities Act 2011 does not necessarily have to be held on trust. But where property is already held on trust (because the charity is unincorporated), then we can see the strength of the argument that permanent endowment held by such a charity should not – following incorporation – become part of the company's corporate property. Even if the company's governing document includes similar restrictions on the use of the property, such restrictions could be amended by resolution of the members of the company.<sup>911</sup> There is a tailored regime for the release of permanent endowment restrictions in sections 281 and 282 of the Charities Act 2011,<sup>912</sup> and under our recommendations in Chapter 4, any amendment by unincorporated charities to permanent endowment restrictions using the new amendment power would require Charity Commission consent.

11.43 In summary, whilst we do not discount the possibility of permanent endowment being transferred by an unincorporated charity to a charitable company to be held as corporate property (and subject, say, to a restriction in the company's articles),<sup>913</sup> we accept that that would be both controversial and contrary to existing established practice.

## RECOMMENDATIONS FOR REFORM

### Powers to merge

11.44 The different powers that charities can use to merge are set out in paragraphs 11.13 to 11.22 above. In the Consultation Paper, we asked whether the section 268 power should be expanded, for example, by extending it to corporate charities, increasing the £10,000 income threshold, removing the designated land restriction, or removing the requirement for Charity Commission consent.

11.45 Consultees said that section 268 was rarely used since charities generally have other adequate powers to merge. The main problem raised was uncertainty as to whether section 280 can be used by unincorporated charities to introduce a power to merge. Section 268 is therefore a "last resort", particularly because it requires charities to wait for 60 days for a response from the Charity Commission. Consultees nevertheless generally supported the expansion of the section 268 power.

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<sup>910</sup> We refer to companies for ease of reference; the same applies to CIOs and other incorporated charities (see Ch 2).

<sup>911</sup> See para 4.4 above.

<sup>912</sup> See para 8.40 and following above.

<sup>913</sup> Given that trustees have a power to release permanent endowment restrictions altogether under sections 281 and 282, it might be appropriate for trustees to transfer permanent endowment to a company to be held as corporate property (which they could only do if they thought it would be in the best interests of the charity). There would be various considerations for the trustees, not least the fact that property owned beneficially would be subject to claims of creditors on the insolvency of the company, whereas trust property (without more) would not: see Ch 12.

11.46 In Chapter 4, we recommended closer alignment between the powers of unincorporated and corporate charities to make amendments to their governing documents. We recommended that the section 280 power for unincorporated charities to make amendments be replaced by a new power to make any amendment, save that specified amendments should require Charity Commission consent.

11.47 The CLA said that, if we were to align amendment powers in this way, then section 268 would become unnecessary and should be abolished. We agree. We have discussed repeal of section 268 further with the members of the CLA working group, as well as officials from the Charity Commission, and have concluded that section 268 should be repealed. We have concluded in Chapter 4 that our recommended expansion of the section 280 power would render the section 275 power to change a small unincorporated charity's purposes by resolution redundant, and have recommended that section 275 be repealed.<sup>914</sup> In the same way, we think that section 268 would become unnecessary since unincorporated charities would be able to amend their governing documents so as to introduce a power to merge.<sup>915</sup> The argument against repeal is that the section 268 power is ready-made; it does not have to be created and then inserted into the governing document by a section 280 resolution. Nevertheless, section 268 is already a power of last resort, and the same result will be capable of being achieved using the new section 280 general amendment power. We therefore think that the section 268 power should be repealed.

**Recommendation 32.**

11.48 We recommend that the power in section 268 of the Charities Act 2011 (governed by sections 267 to 274 of the Act) be repealed.

11.49 Clause 3(1) of the draft Bill would give effect to this recommendation.

**Mechanisms to merge: section 310 vesting declarations**

11.50 We explained the mechanisms by which charities can effect a merger in paragraphs 11.26 to 11.40 above. In the Consultation Paper, we made proposals for the reform of section 310 vesting declarations, about which consultees expressed mixed views.

**Criticisms of section 310 vesting declarations**

11.51 The purpose of section 310 vesting declarations is to permit the easy transfer of assets to a merged charity. However, consultees said that section 310 vesting declarations are rarely used in practice and that "it is generally simpler to have a tailored transfer agreement covering all that needs to be dealt with specifically."<sup>916</sup> Three principal

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<sup>914</sup> See para 4.116 and following above.

<sup>915</sup> Depending on the terms of the amendment to the governing document, Charity Commission consent might be necessary. For example, if the amendment changes how property is directed on winding up, affects third party rights, or changes permanent endowment restrictions, then the Charity Commission's consent would be needed: see paras 4.79 and following above.

<sup>916</sup> Francesca Quint.

criticisms were made of section 310 vesting declarations which were said to explain why they are rarely used.

*(1) Exclusions from section 310 vesting declarations*

11.52 We set out the three exceptions to section 310 vesting declarations in paragraph 11.30 above.

11.53 We find the first exception (for land conveyed by way of mortgage for securing money subject to the trust) difficult to understand. It is difficult to identify what property the exception is intended to capture, but it appears that the exception might relate to old (pre-1925) mortgages, which took effect by the borrower conveying the land to the lender. We do not think that the first exception serves any purpose in modern transactions.

11.54 In the Consultation Paper we proposed that the second exception (for leases containing qualified covenants against assignment) should be removed.<sup>917</sup> The majority of consultees agreed, but a minority expressed firm disagreement. The Institute of Chartered Secretaries and Administrators said that it could “be seen as a strident step that does not facilitate the best relationship between the charity and the landlord”. Stone King LLP thought it might have a negative effect on both landlords and charities, saying that “landlords may have legitimate reasons for not consenting to an assignment”, particularly in the case of a merger as opposed to an incorporation. “Our concern ... is that it will lead to landlords being reluctant to offer more favourable terms to charities, and include more onerous break/forfeiture terms instead. Landlords may also include specific provisions to combat the effect (e.g. stating a personal guarantee will come into effect upon a declaration being made).”<sup>918</sup>

11.55 The Consultation paper also noted an uncertainty created by the second exception to section 310: leases with qualified covenants against assignment are excluded, but nothing is said of leases with absolute covenants against assignment.<sup>919</sup>

11.56 No consultees disagreed with our view that the third exception is unlikely to cause difficulties in practice.

*(2) No provision for the transfer of liabilities and indemnities*

11.57 Section 310 does not provide for the automatic transfer of liabilities to the merged charity. In the Consultation Paper, we noted that there were statutory provisions for the automatic transfer of liabilities in the case of merger of CIOs,<sup>920</sup> but that the transfer of liabilities (particularly in cases not involving CIOs) would require careful attention. It would not be appropriate, for example, to transfer all of a trustee’s liabilities to the new charity; only liabilities undertaken on behalf of the trust should be transferred.<sup>921</sup> Francesca Quint, added that it would be necessary to distinguish between liabilities

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<sup>917</sup> Consultation Paper, paras 12.61 to 12.65.

<sup>918</sup> Stewardship made similar comments.

<sup>919</sup> For an explanation of the distinction, see n 891 above.

<sup>920</sup> See paras 11.37 to 11.38.

<sup>921</sup> Consultation Paper, para 12.81.

properly incurred on behalf of the charity and liabilities purportedly (even if improperly) incurred on behalf of the charity.

11.58 Section 310 also does not provide for the merged charity to provide indemnities to the original charity (or trustees). We explained the need for such indemnities in paragraph 11.8 above. In the Consultation Paper, we said that the provision of indemnities is a matter that should be negotiated between the relevant parties and the documentation effecting the merger should make express provision for any such indemnities.

*(3) Permanent endowment and special trust property*

11.59 We explained at paragraph 11.32 and 11.34 above that section 310 vesting declarations do not transfer a charity's permanent endowment, except where section 310 is modified by regulation 61 of the CIO General Regulations because the transferee is a CIO. There was some dissatisfaction that this modification is limited to cases where the transferee is a CIO.

11.60 Furthermore, regulation 61 introduces an element of uncertainty in respect of special trust property by providing that, where the transferee is a CIO, a section 310 vesting declaration transfers any "property held on special trust". The express inclusion of special trust property by regulation 61 suggests that a section 310 vesting declaration would not otherwise transfer special trust property, which is not apparent from section 310 itself. There is resultant uncertainty as to the effect of a section 310 vesting declaration on special trust property where the regulation 61 modification does not apply.

The advantage of section 310 vesting declarations: trust corporation status

11.61 Despite these limitations, section 310 vesting declarations were said by consultees to have one crucial advantage. As we explained above, regulation 61 of the CIO General Regulations modifies the effect of section 310 vesting declarations when the transfer is to a CIO. It provides that the section 310 vesting declaration can transfer the charity's permanent endowment to the CIO (subject to the same trusts), and that the CIO is automatically treated as a trust corporation.<sup>922</sup>

11.62 Consultation revealed that the availability of automatic trust corporation status for CIOs is a significant driver behind the use of section 310 vesting declarations. Indeed, the fact that section 310 vesting declarations effect a transfer of certain assets appeared to be of inconsequential importance (since such assets can usually be transferred by other existing means), but the availability of trust corporation status for the transferee CIO is a strong reason for charities using section 310 vesting declarations.

11.63 As with the transfer of permanent endowment, however, the benefit of automatic trust corporation status following merger is available only in cases where regulation 61 applies to the section 310 vesting declaration, namely, where the transferee is a CIO.

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<sup>922</sup> The advantages of being treated as a trust corporation are explained further below at para 11.106 to 11.109.



## Conclusions

*To what extent should statute provide for the automatic transfer of assets and liabilities, and the automatic provision of indemnities?*

- 11.64 Underlying consultees' three criticisms of section 310 appears to us to be a desire for a simple statutory process by which to effect a merger. But we have significant doubts as to whether that is feasible or appropriate. As to feasibility, we have already said that every merger will be different, and we question whether it is possible to devise a statutory scheme that will be suitable for all (or even the majority of) mergers; as we have said elsewhere, one size does not fit all. As to appropriateness, making merger simple and quicker by providing for the transfer of contracts and liabilities would necessarily involve overriding third party rights. With these concerns in mind, we discuss the transfer of assets, the transfer of liabilities and the provision of indemnities in turn.
- 11.65 Consultees expressed a desire for section 310 vesting declarations to transfer more assets automatically. The transfer of assets by statute is nothing new;<sup>923</sup> in many cases it will be simple and does not raise concerns. However, difficulties arise when third party rights attach to those assets. For example, where a landlord has the benefit of an absolute or qualified covenant against assignment of a lease, or where a mortgagee has a charge over property which prohibits any transfer without the mortgagee's consent. We are not persuaded that those rights should be overridden. We agree with the concerns of consultees set out in paragraph 11.54 above that such an approach could be to the detriment of charities generally; third parties might become reluctant to transact with charities on favourable terms, or at all. Alternatively, they might seek to create work-arounds, and the legal costs of doing so are likely to be suffered (directly or indirectly) by the charities concerned.
- 11.66 The automatic transfer of liabilities raises similar concerns. If trustees A and B of an unincorporated charity wish to incorporate as charity C (a company), it would be possible to provide for C to be jointly liable for the liabilities of A and B incurred on behalf of the charity. But, it seems to us, the desire is for C to take on the liabilities and for A and B to be discharged from those liabilities. If a third party has contracted with A and B (such that A and B have personal and unlimited liability under that contract), we do not think that it should be possible for A and B unilaterally to transfer that liability to C, which might have relatively few assets and therefore be at greater risk of defaulting on the contractual obligations than A and B. Again, we think that third parties would be reluctant to deal with charities if they knew that contractual rights could be assigned, without their consent, to a limited company.
- 11.67 Finally, we turn to the provision of indemnities. As noted above, we think that the nature of any indemnities should be discussed and agreed by the parties concerned; we are not convinced that a standard statutory indemnity would be appropriate in all cases. Further, we would expect some due diligence to be necessary so that the merged charity knows the nature of the liabilities that it might have to indemnify. We do not think that significant additional work is necessary for those indemnities, once negotiated and agreed, to be drafted and included in the documentation effecting the merger.

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<sup>923</sup> See, for example, the Trustee Act 1925, s 40, on which section 310 is modelled.

11.68 In addition, we do not see any policy reason why charities should be treated differently from other organisations in this context. If there is to be a merger between two (profit-making) companies, or if a sole trader wants to transfer his or her business to a limited company (and obtain the advantages of limited liability), all assets, liabilities, contracts and indemnities would have to be transferred and provided for in the usual way (by transfer deeds, contracts, and negotiation with third parties). If charities are to go through the equivalent process by merging or incorporating, we think that the same process should apply.

11.69 Moreover, we have practical concerns about providing for the automatic transfer of assets and liabilities, and the automatic provision of indemnities. Section 310 vesting declarations might become unpopular if they automatically include the transfer of assets and liabilities and the provision of indemnities since some charities carrying out a merger might not want all three aspects in their transaction. Conversely, if charities were permitted to pick and choose whether they wanted automatic transfer of assets, automatic transfer of liabilities, and/or automatic provision of indemnities, then the vesting declaration will have to make tailored provision for how it is to operate in any event. As a result there would be little to be gained from a statutory mechanism to do the same thing.

11.70 We acknowledge that there are statutory provisions which provide for the automatic transfer of assets and liabilities.<sup>924</sup> Further, it is possible for the Charity Commission to make a scheme which has the effect of overriding third party rights (which was the basis for our proposal to remove the second exception under section 310). But we think that permitting charities to do so unilaterally is different since the Charity Commission – as a public body – can be expected to consider third party rights when deciding whether to exercise the power, in the knowledge that its decision might be challenged (in the Charity Tribunal, by way of judicial review, or simply by means of a complaint).<sup>925</sup>

11.71 In conclusion, we do not think that section 310 vesting declarations should be expanded so as to include more assets, or so as to include the automatic transfer of liabilities and the automatic provision of indemnities.

#### *Retaining section 310*

11.72 We have concluded above that section 310 should not be expanded, in the way some consultees suggested, to encourage its greater use. Additionally, we noted above that section 310 conferred an important practical benefit in the case of transfers to CIOs, namely trust corporation status. We make recommendations later in this chapter which

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<sup>924</sup> The most pertinent, in this context, is that for CIOs (see paras 11.37 and 11.38 above). As Stewardship pointed out, however, we cannot yet know whether these provisions have a detrimental effect on the willingness of third parties to contract with CIOs since they are a very recent creation. In any event, those provisions are subject to the safeguard of requiring Charity Commission consent before they would operate to transfer assets and liabilities automatically. Trowers and Hamlins LLP noted another analogous statutory provision: there is a power for the automatic transfer of assets and of “engagements” for community benefit societies: Co-operative and Community Benefit Society Act 2014, ss 109 and 110.

<sup>925</sup> Third party rights being protected by way of the Charity Commission’s scheme-making process, which can include (1) requiring trustees to consult, or give public notice of the proposed changes, or (2) through its own practice of publishing schemes on its website: see generally Charity Commission, *OG500 Schemes* (January 2017).

would remove the need for charities to use section 310 purely to obtain that tangential benefit.

11.73 We expect, therefore, that section 310 will continue to be used only rarely. Nevertheless, we do not recommend its repeal. It might continue to be useful for simple mergers which do not involve complex assets. We do, however, in the following paragraphs, make recommendations and provide explanations which will remove some of the uncertainty surrounding section 310 and which we hope will encourage charities to use it in the case of a fairly simple merger.

#### *Modifying the section 310 exclusions*

11.74 We recommend reform regarding the assets that are excluded from section 310 vesting declarations. At paragraphs 11.53 to 11.55 above, we set out criticisms of the first and second exceptions. We explained that the first exception was difficult to understand and unlikely to serve any purpose in modern transactions. We therefore recommend its repeal.

11.75 In paragraph 11.54, we discussed a proposal that the second exception be removed. In the interests of protecting third party rights, we have concluded that the second exception should remain. As leases with qualified covenants will continue to be excluded from section 310 vesting declarations, so too should leases with absolute covenants against assignment. We make a recommendation accordingly. This exception will not apply where the landlord has consented to the assignment or otherwise waived the right under the covenant.

#### *Permanent endowment*

11.76 We noted, at paragraph 11.59 above, the inconsistency in the effect of a section 310 vesting declaration on permanent endowment in a merger where the transferee charity is a CIO rather than any other charity. One initially attractive solution to this problem would be to extend the modifications made by regulation 61 of the CIO General Regulations in the case of transfers to a CIO to transfers to any form of charity. However, on analysing how section 310, as modified by regulation 61, operates to transfer permanent endowment to a CIO, it appears that the regulation 61 modification is not in fact necessary.

11.77 To understand that conclusion, it is necessary to consider what it means to “transfer” permanent endowment to the transferee charity following merger. We have already discussed how permanent endowment is held by different forms of charity and the commonly held view that it is always held on trust.<sup>926</sup> The consequence is that permanent endowment is not transferred to a corporate charity in the same manner as unrestricted funds: it does not form part of the charity’s corporate property, but rather the corporate charity becomes the trustee of the permanent endowment. Accordingly, following a merger where the transferee charity is a corporate charity, the permanent endowment of the transferor charity will continue to be held on trust. All section 310, as modified by regulation 61, does, where the transferee is a CIO, is automatically transfer trusteeship of the permanent endowment from the transferor to the transferee. The

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<sup>926</sup> See paras 11.41 to 11.43 and para 8.17 and following above.

permanent endowment continues to be held on the same trusts and continues to exist as its own separate charity.

11.78 On that analysis, in most cases the modification made by regulation 61 will not be necessary in order to transfer legal title to the permanent endowment to the transferee charity. Section 40 of the Trustee Act 1925 provides that, where a change of trustee is effected by deed (which is always the case where a section 310 vesting declaration is being used) legal title to trust property (in this case the permanent endowment) is automatically vested in the new trustees. Section 40 of the Trustee Act 1925 therefore renders the regulation 61 modification redundant, and removes any need to extend its application to charities other than CIOs. At the end of this chapter we make a recommendation to repeal regulation 61.

### *Special trust property*

11.79 At paragraph 11.60 we explained that the wording of regulation 61 created some uncertainty as to the effect of section 310 vesting declarations on special trust property. We hope that this uncertainty may be addressed by our recommendation to repeal regulation 61 below and our amended definition of permanent endowment, discussed in Chapter 8, which clarifies that special trust property is not captured by the definition. The outcome of these reforms will be that special trust property can, in principle, be transferred by a section 310 vesting declaration (but if it is to continue to be held on trust after merger, it would be unnecessary to rely on section 310 because section 40 of the Trustee Act will already achieve the change of trusteeship).<sup>927</sup> We recognise that in some cases there may be some uncertainty as to how the transfer of special trust property operates (whether it more closely resembles that of unrestricted funds or of permanent endowment) but, as we note above, it is impossible to have a “one size fits all” statutory provision for mergers. Section 310 is designed for relatively simple cases where charities wish to avoid using tailored transfer documentation; it will not be suitable in every case.

### **Recommendation 33.**

11.80 We recommend that:

- (1) the first exclusion from section 310 vesting declarations (for land conveyed by way of mortgage for securing money subject to the trust) be repealed; and
- (2) leases containing absolute covenants against assignment be excluded from section 310 vesting declarations.

11.81 Clause 36 of the draft Bill would implement this recommendation.

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<sup>927</sup> We discussed with stakeholders whether special trust property should be expressly excluded from section 310 vesting declarations, but we did not receive sufficient responses, or consensus, on the question to justify reforming the law so as to exclude such property expressly. We heard that, in practice, there were mechanisms to ensure that special trust property is properly transferred, such as providing that special trust property is transferred to the merged charity “to be held on the same trusts”.

## AVOIDING ONGOING COSTS FOLLOWING MERGER

### The problem with shell charities

11.82 Following merger, the original charity may or may not cease to exist. When it continues to exist, it will often be a “shell” charity on the register of charities, namely a charity that continues to exist and is kept on the register, but which ceases to operate. On incorporation, the original unincorporated charity continues to exist alongside a new charitable company; on merger, the original charity continues to exist following the transfer of its assets to another charity. There are various reasons why shell charities are retained following merger, which we discuss below.

11.83 The existence of shell charities is inconvenient for a number of reasons. First, it clutters the register with charities that are not in fact operating and those who search the register can be confused or even misled by seeing the formal existence of a charity that had apparently been wound up following merger. Second, the merged charity will incur accounting, administrative and legal costs in maintaining a shell charity on the register. Third, there are risks of dormant charities being removed from the register of charities and (in the case of charitable companies) from the register of companies. The legal framework for charities should eliminate, as far as possible, the need for shell charities to be retained.

11.84 A merger will only fall within the definition of a “relevant charity merger” if the original charity ceases to exist following merger (unless it holds permanent endowment, in which case the permanent endowment is treated as the original charity). The incentive behind the merger provisions introduced by the Charities Act 2006 was therefore to remove shell charities from the register. Consultees have told us that this objective has not been achieved. Shell charities are still regularly retained following merger. A significant reason for that is the desire to avoid losing potential legacies. But consultees said that there were also other practical reasons why shell charities are retained.

### Bequests to a charity that has merged

11.85 When charities merge (including by incorporating), difficulties arise when gifts have been made by will to the original charity. A bequest takes effect at the date of death of the testator,<sup>928</sup> not at the date of the will. Where an institution named in a will has ceased to exist by the date of death, it is necessary to ascertain whether the testator intended to benefit (a) the particular institution, or (b) the purposes of the institution. If it is the particular institution, the gift lapses and the gift will form part of the testator’s residuary estate. If it is the purposes of that institution, the gift can be applied *cy-près*.<sup>929</sup>

11.86 Where a named institution has ceased to exist following merger, there are several ways to prevent a gift from lapsing.

- (1) It might be possible to interpret the gift in such a way that it takes effect for the benefit of the new charity.

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<sup>928</sup> Strictly speaking, the gift takes effect when the testator’s executor distributes the assets comprising the estate in accordance with the terms of the will: see para 7.168 above.

<sup>929</sup> See, generally, H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) ch 31. See also para 4.37 and following above.

- (2) The gift, on its true construction, might be a gift for particular purposes, so it can be applied *cy-près*. Gifts will often be treated as gifts for particular purposes when they are made to named unincorporated charities, since such gifts necessarily take effect as gifts on trust for those purposes.<sup>930</sup> Conversely, gifts to named corporate charities are generally taken by the corporate body beneficially so will rarely be interpreted as gifts for particular purposes.<sup>931</sup>
- (3) The gift might be saved by the existence of a general charitable intention, allowing the court or Charity Commission to make a *cy-près* scheme.<sup>932</sup>

11.87 To avoid arguments about gifts lapsing and the associated legal costs, many merging charities retain shells of their former selves to capture gifts that might otherwise have lapsed post-merger. Gifts to the shell charity, once received, are then transferred to the merged charity.

11.88 The register of mergers (see paragraph 11.9 above) was intended to eliminate the need for this inconvenient and costly practice. By section 311 of the Charities Act 2011, when a merger is registered, a gift to the original charity takes effect as a gift to the transferee, unless it is an excluded gift.<sup>933</sup> A gift is an “excluded gift” if the original charity held permanent endowment and the gift was intended to be held subject to the trusts on which the permanent endowment is held.<sup>934</sup> In such a case, the trust on which the original charity’s permanent endowment was held will continue to exist separately and the gift will be added to that permanent endowment.<sup>935</sup>

11.89 It is arguable that both the retention of shell charities to capture legacies, and the intervention of section 311, undermine testamentary freedom. If a testator makes a gift to Charity A which then merges with Charity B, arguably the gift should fail, regardless of whether Charity A remains as a shell charity or is the subject of a registered merger which can therefore take advantage of section 311. But section 311 is intended to fill the gap left where a testator does not specify what is to occur if a named charity has merged. It is therefore arguable that section 311 gives effect to the most likely intentions of a testator. Where a testator has left a legacy to a named charity, the testator would have been likely (had he or she considered the possibility of a merger) to want the legacy to go to the merged charity, rather than to fail. We do not think that section 311 undermines testamentary freedom. Whilst we did not ask a specific consultation question about balancing testamentary freedom against section 311 and the existence of shell charities, no consultee raised concerns about testamentary freedom under the current law in their response to the questions that we raised.

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<sup>930</sup> *Re Vernon’s Will Trusts* [1972] Ch 300, 303, by Buckley J.

<sup>931</sup> *Re Finger’s Will Trusts* [1972] Ch 286; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 490 to 491.

<sup>932</sup> See para 4.39 and following above on the meaning of a “general charitable intention”.

<sup>933</sup> Equivalent provisions apply where a CIO transfers its operations to another CIO, or where two or more CIOs amalgamate: Charities Act 2011, ss 239(3) and 244(2).

<sup>934</sup> Charities Act 2011, s 311(3).

<sup>935</sup> Charities Act 2011, s 306(2) and (3).

11.90 Section 311 has not, however, been entirely successful. Gifts to a named charity by will are often expressed to be conditional on the charity continuing to exist. If a charity has merged and the merger is registered, the original charity will necessarily have ceased to exist.<sup>936</sup> Gifts expressed in this way will not, therefore, be caught by section 311. This issue was brought into sharp focus by *Berry v IBS-STL (UK) Ltd.*<sup>937</sup> The testatrix left the residue of her estate to “such of the following charities as shall to the satisfaction of my trustees *be in existence at the date of my death*, namely ...” (emphasis added). One of the listed charities had merged and the merger had been registered. But it was held that the testatrix had not “expressed ... a gift to the transferor”<sup>938</sup> so as to be caught by section 311; rather, the beneficiaries were only such of the named charities as existed at the date of the testatrix’s death.<sup>939</sup>

11.91 Section 311 is, therefore, perhaps not as effective as it was first hoped in ensuring that a gift by will to a charity takes effect as a gift to the merged charity. Indeed, rather than assisting charities, section 311 might have been detrimental; charities that merged and provided for the original charity to cease to exist (or subsequently wound up an existing shell charity) in reliance on section 311 are potentially in a worse position than if they had retained the shell charity. Consultees told us that merging charities are often still advised to retain a shell charity, which is unfortunate, for the reasons set out in paragraph 11.83 above. It defeats one of the main purposes of the register of mergers.

11.92 In the Consultation Paper, we said that, in devising a solution to this problem, it is necessary to give careful consideration to testamentary freedom; if a testator has stated that a gift is only to take effect in certain circumstances, that wish should be respected. Against that, however, are two competing considerations.

11.93 First, if the testator truly intends a gift to fail when a charity merges, his or her testamentary freedom is already curtailed in practice by charities’ practice of retaining shell charities to capture such gifts.

11.94 Second, the *Berry* problem is likely to be an accident of drafting, rather than a deliberate decision on the part of a testator. A charitable gift may be expressed as “a gift to such of the following charities as exist when I die: Charity A, Charity B and Charity C” or as “a gift to charities A, B and C”. If Charity C transfers its operations to Charity D following a merger:

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<sup>936</sup> Since only “relevant charity mergers” can be registered, and the definition requires the original charity to have ceased to exist.

<sup>937</sup> [2012] EWHC 666 (Ch), [2012] PTSR 1619.

<sup>938</sup> Within the meaning of Charities Act 1993, s 75F(2), now Charities Act 2011, s 311(2)(a).

<sup>939</sup> “Accordingly, there was no gift to be transmuted by the statutory fiat into a gift to the new merged entity”: [2012] EWHC 666 (Ch), [2012] PTSR 1619, [9], by David Donaldson QC (sitting as a Deputy Judge of the High Court). The will, in fact, made provision for what was to occur in the event of one of the named charities ceasing to exist, and it gave the trustees a discretion to give the same figure to the merged charity. On the peculiar facts, however, the merged charity had entered liquidation so the trustees did not want to give the gift to the merged charity. The question, therefore, was whether they were required to do so by s 311, or whether they had a discretion under the terms of the will to give the money to a different charity. The decision may have been influenced by the merged charity’s insolvency; if s 311 had operated, the legacy would not have been used for charitable purposes but instead towards satisfying the debts of the insolvent charity’s creditors. The decision does, however, run counter to the policy behind s 311.

- (1) under the common law (ignoring section 311), the gift to Charity C would fail under both formulations; and
- (2) under the current law, the effect of section 311 is that the gift to Charity C would fail under the first formulation, but that the gift would take effect as a gift to Charity D under the second formulation; but
- (3) the testator in both cases would be likely to have intended Charity D to benefit from the gift, and the different results arising from the two formulations under the current law would be likely to surprise a testator.

11.95 We said that both formulations in a will should be caught by section 311 and proposed that section 311 be amended to provide that, for the purpose of ascertaining whether a gift has been made to a transferor charity under section 311(2)(a), the transferor charity should be deemed to have continued to exist despite the merger.

11.96 We thought that our proposal would strike a fair balance between respecting testamentary freedom and ensuring that gifts do not lapse simply because a charity has merged. Testators would be able to exclude the effect of the deeming provision, for example, by stating that the gifts are conditional on the named charities not having merged. But testators would have to do so deliberately, rather than potentially by accident as is currently the case. Other conditions imposed by testators (for example, concerning the purposes that a named charity must pursue before a gift takes effect) would continue to operate.

11.97 Most consultees agreed with our proposal, suggesting it would reduce (and perhaps eliminate) the need to retain shell charities. One consultee raised concerns about overriding testamentary freedom, but as we explained above, testators' intentions are already defeated by the retention of shell charities. We remain of the view that our proposal strikes the right balance between testamentary freedom and ensuring that gifts do not lapse simply because a charity has merged.

11.98 Three consultees<sup>940</sup> thought that the amendment should have retrospective effect so as to benefit charities that have already merged in reliance on section 311 before the *Berry* problem was highlighted. We agree that the amendment should have a certain degree of retrospective effect, in that it should apply to all deaths after the commencement date, even if the date of the will or the date of the merger precedes the commencement date. But it should not apply to gifts that have already taken effect (and failed) as a result of the *Berry* problem.

11.99 We explain above that testators will still be able to draft their wills in such a way that avoids the section 311 deeming provision. But we do not think that our recommended change to section 311 should be limited to wills executed after the date of commencement. If testators have already made wills that currently avoid section 311 (as a result of using wording similar to that in *Berry*), we doubt that the testators would have used that language in a deliberate attempt to oust section 311. As we suggest above, the ouster of section 311 in a will (on the basis in *Berry*) is more likely to be by accident than design. If testators had particular concerns about their chosen charity

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<sup>940</sup> Cancer Research UK; Veale Wasbrough Vizards LLP; and Stewardship.



merging or changing in some way between the date of their will and their death, they would have protected those wishes by much clearer and more direct means, rather than using wording that refers to a charity continuing to exist and relying on the *Berry* decision.

11.100 Provisions equivalent to section 311 apply when two or more CIOs amalgamate under section 235, and when a CIO transfers its undertaking to another CIO under section 240.<sup>941</sup> We recommend that those provisions be amended to reflect the amendments to section 311.

### **Other reasons for retaining shell charities**

11.101 Consultees told us that there are other reasons why charities retain shells on the register. For example, charities sometimes want to retain the same charity number. On a merger, however, since the assets of one charity are being transferred to another charity, each requires a separate number. We can see that difficulties would arise if the merged charity could adopt the original charity's registration number since they are both distinct legal entities. A similar problem is that bank accounts cannot be transferred from one charity to another, so regular donations by standing order need to be changed to the merged charity's bank account. The risk of losing some regular donations in the process of encouraging donors to change their standing orders causes some charities to retain a shell charity in order to capture standing order donations to be passed on to the new charity. We do not, however, think that these are problems that can be resolved by law reform. We think that charities that merge should contact their donors to inform them of the merger and to ask them to update their standing order details. That ensures that donors know which charity their donation is going to.

11.102 A further reason for retaining a shell charity rather than relying on the register of mergers was reported to be the lack of accessibility to and awareness of the register of mergers, as well as the lack of any link between it and the register of charities. If a merger is registered, the original charity will have ceased to exist. An executor searching the register of charities will see that the charity has ceased to exist, but there is no corresponding entry stating that it is the subject of a registered merger. Unless the personal representatives are aware that they should search the (separate) register of mergers, they might see that the original charity has ceased to exist and presume that the gift therefore fails. We think that the lack of a link between the registers is a deficiency in the current regime, undermining the effectiveness of section 311 and therefore the willingness of charities to wind up shell charities. We therefore recommend that the Charity Commission investigate whether, when cancelling the registration of a charity following a registered merger, a note can be inserted onto the register of charities. This note would either link directly to the register of mergers or at least provide an explanation that the charity has been the subject of a registered merger and that a separate search should therefore be made of the register of mergers.

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<sup>941</sup> See paras 11.37 and 11.38 above.

### **Recommendation 34.**

11.103 We recommend that:

- (1) when a charity has merged and the merger is registered, for the purposes of ascertaining whether a gift has been made to that charity under section 311(2) of the Charities Act 2011, the charity should be deemed to have continued to exist despite the merger;
- (2) when two or more CIOs amalgamate under section 235, for the purposes of ascertaining whether a gift has been made to the amalgamated CIO under section 239(3), the original CIOs should be deemed to have continued to exist despite the amalgamation;
- (3) when a CIO transfers its undertaking to another CIO under section 240, for the purposes of ascertaining whether a gift has been made to the transferee CIO under section 244(2), the transferor CIO should be deemed to have continued to exist despite the transfer; and
- (4) the Charity Commission should investigate whether, on registering a merger, a charity's entry in the register of charities could include a reference to the registered merger.

11.104 Clause 35 of the draft Bill would implement paragraphs (1) to (3) of this recommendation.

## **TRUST CORPORATION STATUS**

### **The current law**

What is a trust corporation?

11.105 A trust corporation is a particular type of corporate trustee, defined (in the same terms) in five statutes.<sup>942</sup> Various persons and bodies are automatically trust corporations (for example, the Treasury Solicitor and the Official Solicitor). Others can be appointed as trust corporations (for example, a corporation appointed by the court to be a trustee).

Why is trust corporation status important?

11.106 In trust administration, there are various advantages to trustees being trust corporations,<sup>943</sup> in particular that a trust corporation, as sole trustee, can give a valid

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<sup>942</sup> Law of Property Act 1925, s 205(1)(xxvii); Trustee Act 1925 s 68(1)(18); Settled Land Act 1925, s117(1)(xxx); Administration of Estates Act 1925, s 55(1)(xxvi); Senior Courts Act 1981 s 128(1); all as expanded by Law of Property (Amendment) Act 1926, s 3. Trust corporation status can be conferred by statute; for example, the Church of England Pension Board is given trust corporation status by the Clergy Pensions Measure, s 31.

<sup>943</sup> See generally *Lewin on Trusts* (19th ed 2015) para 19-55; *Halsbury's Laws of England Vol 98* (5th ed 2013) para 238 and following.

receipt for the proceeds of sale arising under a trust of land.<sup>944</sup> In the absence of a trust corporation as trustee, at least two trustees are required to give a valid receipt.

Why is trust corporation status important on incorporation and merger?

11.107 When the trustees of an unincorporated charity wish to incorporate, they will want to transfer all assets to a corporate charity. The trustees will not want to continue to hold legal title to the assets.

11.108 As explained above, on incorporation, most assets will be held by the corporate charity as corporate property. But permanent endowment (and special trust property) will not be transferred to the corporate charity as corporate property; rather, it continues to be held on trust, with the corporate body becoming the trustee.

11.109 Accordingly, when – following incorporation – a corporate charity will hold any land on trust as a sole trustee (rather than as part of its corporate property), it will be important for the corporate charity to have trust corporation status so that it can deal with that land (by giving a valid receipt). The same applies to any other merger where a corporate charity will hold land on trust as sole trustee.

How does a charity obtain trust corporation status?

11.110 Charities will generally seek trust corporation status in one of three ways.

*Route (A): Application to the Lord Chancellor*

11.111 An application can be made to the Lord Chancellor for authorisation to act as a trust corporation. For the purposes of the five relevant statutes,<sup>945</sup> a trust corporation includes, “in relation to charitable ecclesiastical and public trusts”, any corporation which:

- (1) satisfies the Lord Chancellor:
  - (a) “that it undertakes the administration of any such trusts without remuneration”, or
  - (b) “that by its constitution it is required to apply the whole of its net income after payment of outgoings for charitable ecclesiastical or public purposes, and is prohibited from distributing, directly or indirectly, any part thereof by way of profits amongst any of its members”, and
- (2) is authorised by the Lord Chancellor to act in relation to such trusts as a trust corporation.<sup>946</sup>

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<sup>944</sup> Law of Property Act 1925, s 27(2).

<sup>945</sup> See n 942 above.

<sup>946</sup> Law of Property (Amendment) Act 1926, s 3. Authorisation by the Lord Chancellor to act as a trust corporation also entitles the corporation to act as a “custodian trustee”: Public Trustee Act 1906, s 4(3); Public Trustee Rules 1912 (SI 1912 No 348), r 30(1)(d)(ii). See further Charity Commission, *OG39 Custodian Trustees* (March 2012) available at <http://ogs.charitycommission.gov.uk/g039a001.aspx>.

### *Route (B): Charity Commission scheme*

11.112 As noted above, a corporation appointed by the court to be a trustee is a trust corporation. In the five relevant statutes,<sup>947</sup> the reference to a corporation appointed by the court “includes a reference to a corporation appointed by the [Charity] Commission under [the Charities Act 2011] to be a trustee”.<sup>948</sup>

11.113 Accordingly, if the Charity Commission appoints a corporation (such as a company or CIO) to be a trustee under its powers in the Charities Act 2011, that corporation is automatically treated as a trust corporation. There is no authority on the point, but the Charity Commission’s view is that the corporation becomes a trust corporation only in relation to the charity of which it has been appointed a trustee.<sup>949</sup>

### *Route (C): Vesting declaration under section 310 of the Charities Act 2011*

11.114 We explained in paragraph 11.34 above that when permanent endowment (or special trust property) is transferred to a CIO by means of a section 310 vesting declaration, the CIO will automatically be treated as a trust corporation.<sup>950</sup> It is unclear whether the CIO is treated as a trust corporation only in relation to the charitable trust of which it becomes trustee, or whether the CIO is treated as a trust corporation for other purposes.<sup>951</sup>

## **Criticisms of the current law**

11.115 It was clear from responses to the Consultation Paper that obtaining trust corporation status is a complicating factor in many mergers. The existing procedures for obtaining trust corporation status were criticised as being cumbersome and time consuming. Unless the transfer is to a CIO and the transaction can be shoehorned into section 310, charities will either need a scheme from the Charity Commission or authorisation from the Lord Chancellor. Our subsequent discussions with the CLA and the Charity Commission revealed a strong desire for trust corporation status to be more widely available to corporate charities.

## **Wider issues with trust corporation status**

11.116 We sought consultees’ views on trust corporation status in our Supplementary Consultation Paper. Consultees provided responses to the specific questions in our Consultation Paper as well as commenting more generally on issues relating to trust

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<sup>947</sup> See n 942 above.

<sup>948</sup> Charities Act 2011, sch 7, para 3. The Charity Commission’s practice is to make a scheme if the corporate body has not yet been appointed as trustee, but if the corporate body has already been appointed it will not make a confirmatory scheme but will instead refer the charity to the Lord Chancellor: Charity Commission, *OG38 Corporate trustees* (October 2014), s B1, para 4.3, available at <http://ogs.charitycommission.gov.uk/g038a001.aspx>.

<sup>949</sup> Charity Commission, *OG38 Corporate trustees* (October 2014) s B1, para 4.3; Charity Commission, *OG510 Charity Trustees: Making and Ending Appointments* (November 2016) para B2.2, available at <http://ogs.charitycommission.gov.uk/g510a001.aspx>.

<sup>950</sup> CIO General Regulations, reg 61(4).

<sup>951</sup> There is no authority on the point. If the Charity Commission’s view – that a corporation appointed by the Charity Commission as trustee is a trust corporation only in relation to that charitable trust (see para 11.113) – is right, then for consistency the treatment of a CIO as a trust corporation under reg 61(4) should only be in relation to the charitable trust of which the CIO is trustee.

corporation status. Some of these suggestions go beyond the scope of the present project, and we note them in our Analysis of Responses.<sup>952</sup>

11.117 Consultees also noted that, while the two consultation papers had focussed on trust corporation status in relation to mergers and incorporations, this is not the only context in which trust corporation status is relevant. The CLA gave two other contexts in which trust corporation status is important: (1) where a charity wishes to appoint a sole corporate trustee; and (2) where a charity receives a legacy and wishes to take out a grant of representation. We have kept these additional contexts in mind in formulating our recommendations.

### Options for reform

11.118 Making trust corporation status more widely available to corporate charities would both (a) advance the policy aim of facilitating, and removing legal barriers to, merger, and (b) save corporate charities unnecessary time and expense beyond the merger context. In the Supplementary Consultation Paper, we considered various options for achieving these objectives.

- (1) Extending the modification made by regulation 61 of the CIO General Regulations to section 310 to all corporate charities. This would mean that, whenever trust property is transferred to a corporate charity to be held as trustee pursuant to a section 310 vesting declaration, the corporate charity would automatically have trust corporation status (“Option (1)”).
- (2) Making trust corporation status available to any corporate charity to which assets are transferred (on trust) on a merger, whether or not a section 310 vesting declaration is made (“Option (2)”).
- (3) Making trust corporation status available to all corporate charities, including charitable companies, CIOs and other corporate bodies (“Option (3)”).
- (4) Making trust corporation status available to any corporate body (whether or not it is a charity) that is a trustee of a charitable trust (“Option (4)”).

Options (2)-(4) could all be achieved either by (a) giving the charities in question a power to obtain trust corporation status by resolution; or (b) conferring trust corporation status on the charities in question automatically.

11.119 We said in our Supplementary Consultation Paper that Option (1) would likely be uncontroversial but, on its own, would be of limited assistance since it relies on section 310 which itself is of limited use, for the reasons discussed above. The CLA expressed their agreement that this approach would only be a very marginal improvement on the current law and added that it would not be of assistance in the non-merger situations described above.<sup>953</sup> We thought that Option (2) would be more helpful, because it would be available on any merger, regardless of whether a vesting declaration is used. But again, this option would be limited to the merger context, which we suggested might not

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<sup>952</sup> While we do not address those issues here, we are considering including, as part of our 13th Programme of Law Reform, a wider trust law project, which could encompass trust corporation status.

<sup>953</sup> See para 11.117.

be justified given that corporate charities can acquire trust assets in other circumstances.

11.120 We therefore rejected Options (1) and (2) and made a proposal that was based on Option (3): extending trust corporation status to all charitable corporations, beyond the merger context. We proposed creating a new power, for any charitable company and CIO, by resolution of its directors or charity trustees, to acquire trust corporation status in relation to any charitable trust of which the corporate charity is trustee. This was a slightly conservative version of Option (3): limiting the power to CIOs and charitable companies, rather than all corporate charities and opting for a power to obtain trust corporation status by resolution rather than automatic conferral. However, we also invited consultees' views on reform going beyond this proposed power: making trust corporation status available automatically and/or making the status available to non-charitable corporations.

11.121 In analysing consultees' responses and recommending reform we have sought to answer three questions.

- (1) Which corporate bodies should obtain trust corporation status?
- (2) How should those bodies obtain the status?
- (3) For what purposes should the status be conferred?

We address each of these questions in turn.

### **Which corporate bodies should obtain trust corporation status?**

#### Charitable corporations

11.122 We said in our Supplementary Consultation Paper that we thought the power to obtain trust corporation status should be available to charitable companies and CIOs only and not to other charitable corporations such as community benefit societies or charities incorporated by Royal Charter. We said that the problems under the current law principally concern mergers with companies and CIOs. We also said that it would be more straightforward to devise rules for resolutions to be passed by companies and CIOs because of their structure: a defined body of charity trustees, or directors, and members. We said that other corporate bodies would still be able to obtain trust corporation status via other existing means.

11.123 Several consultees questioned limiting the proposed power to charitable companies and CIOs. The CLA said that the legal structure of a charity (beyond incorporation) seemed irrelevant to the question of how it obtains trust corporation status. They gave examples of community benefit societies and charities governed by Royal Charter who would benefit from obtaining trust corporation status.

11.124 We conclude below that trust corporation status ought to be conferred automatically. In light of this decision, our concerns regarding the difficulty of devising rules for resolutions to be passed fall away. We have therefore concluded that trust corporation status should be made more widely available to any corporate body that is a charity, not just charitable companies and CIOs.

## Non-charitable corporations

11.125 We sought consultees' views as to whether we should confer trust corporation status on non-charitable corporations (either automatically or by resolution). We noted that any corporate charity ought to satisfy the pre-conditions for authorisation from the Lord Chancellor to be a trust corporation in relation to charitable trusts (Route (A) above): all charities are required to apply their income for charitable purposes and they cannot distribute profits to their members.<sup>954</sup> The same cannot be said of every corporate body that is non-charitable.

11.126 There was disagreement amongst consultees in response to this question, although a majority said that trust corporation status should not be extended to non-charitable corporations. There were strong arguments in favour of making trust corporation status more widely available to non-charitable corporations that are trustees of charitable trusts. It was argued that such corporations would satisfy the conditions of the Lord Chancellor route (Route (A) above) due to their role as charitable trustees. On the other hand, several consultees argued that it was unnecessary to extend the proposed new power to such corporations as they can generally qualify for trust corporation status under the Public Trustee Rules 1912. Others voiced concerns about unintended consequences and scope for abuse due to a lack of any supervision or oversight from the Charity Commission or Lord Chancellor.

11.127 We accept that there are strong arguments that a body corporate that is not itself a charity but is acting *solely* as the trustee of a charitable trust should be included within our recommendations. However, it would be very difficult to legislate to confer trust corporation status on only these bodies without conferring it more widely on corporate bodies that are not trustees of charitable trusts. It would also be necessary to cater for future changes, for example, if the corporation subsequently became the trustee of other trusts. We are also conscious of consultees' concerns about unintended consequences, given that our consultation concerned charity law and did not therefore necessarily reach an audience who would have views on the position of non-charitable corporations.

11.128 Following our reforms, when a corporate body is set up solely to be the trustee of a charitable trust, there will be an incentive to structure that body as a charity. Alternatively, these bodies will still be able to acquire trust corporation status via Routes (A) and (B) above, if they satisfy the necessary conditions. However, that is not to say that we believe these existing routes to be satisfactory. There is certainly scope for a separate project to review the purpose and availability of trust corporation status, outside the confines of a project on charity law.<sup>955</sup>

### **How should charitable corporations obtain trust corporation status?**

#### A power to obtain trust corporation status by resolution

11.129 The vast majority of consultees supported our proposed power to obtain trust corporation status by resolution. They said that the power would simplify the process of merger and incorporation, reduce cost and delay, and increase flexibility in decision-making. No consultees expressly disagreed with our proposed power. There was,

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<sup>954</sup> See para 11.111(1) above.

<sup>955</sup> See n 952 above.

however, significant support for, and there were strong arguments in favour of, conferring trust corporation status automatically instead of by positive action in the form of a resolution.

#### Automatic conferral of trust corporation status

11.130 We expressed concern in our Supplementary Consultation Paper that the automatic conferral of trust corporation status might have unforeseen and unintended consequences. Some consultees echoed this concern and expressed a preference for trustees having actively to consider the responsibilities associated with having trust corporation status. However, no consultee provided any specific examples of what consequences could result from automatic conferral nor what responsibilities of having trust corporation status trustees would need to consider. On the other hand, two consultees said that, following careful consideration, they could not think of any negative consequences of automatic conferral. Nor can we.

11.131 To the contrary, those who supported the automatic conferral of trust corporation status gave numerous advantages to doing so. These included:

- (1) safeguarding against failure to obtain trust corporation status due to lack of awareness or understanding;
- (2) avoiding the risks for charities and their trustees of a corporate trustee not having trust corporation status when it is needed; and
- (3) simplifying record keeping by removing the need to locate evidence of trust corporation status in respect of particular charitable trusts.

11.132 In the light of these arguments we have concluded that trust corporation status should be conferred automatically on all charitable corporations that are the trustees of a charitable trust.

#### **For what purposes should trust corporation status be conferred?**

11.133 We explained in our Supplementary Consultation Paper that, connected to the question of who should obtain trust corporation status, is the question of the purpose for which that status should be obtained. There are three potential options; trust corporation status could be conferred:

- (1) in relation to the charitable trust of which the corporation is trustee;
- (2) in relation to charitable trusts generally; or
- (3) for all purposes.

We concluded that, in line with the status conferred by application to the Lord Chancellor (Route (A) above), trust corporation status should be conferred in relation to any charitable trust of which the corporate charity is trustee. Those consultees who commented on this conclusion agreed with it, and no consultee expressed opposition. We therefore make a recommendation accordingly.



## **Regulation 61 of the CIO (General) Regulations 2012**

11.134 We explained above that CIOs enjoy two key benefits as a result of the modifications made by regulation 61 of the CIO General Regulations:

- (1) the transfer of permanent endowment as well as unrestricted funds pursuant to a section 310 vesting declaration; and
- (2) the automatic conferral of trust corporation status on the transferee.

The first benefit is undermined, however, by our analysis in paragraphs 11.76 to 11.78 above. If trusteeship of permanent endowment is automatically transferred by section 40 of the Trustee Act 1925, there is no need for the regulation 61 modification. The second benefit is rendered otiose by our recommendation that trust corporation status be made available to all corporate charities (including CIOs) that are the trustees of a charitable trust.

11.135 Given that these two primary benefits of regulation 61 will, under our recommendations, be achieved by other means, we recommend that the regulation be repealed.

### **Recommendation 35.**

11.136 We recommend that:

- (1) trust corporation status be conferred automatically on existing and future corporate charities in respect of any charitable trust of which the corporation is (or, in the future, becomes) a trustee; and
- (2) regulation 61 of the Charitable Incorporated Organisations (General) Regulations 2012 be repealed.

11.137 Clauses 34 and 37(2) of the draft Bill would give effect to this recommendation.

# Chapter 12: Charity and trustee insolvency

## INTRODUCTION

- 12.1 In Chapter 13 of the Consultation Paper we discussed what happens to property held on trust for charitable purposes when the trustee becomes insolvent, and in particular the circumstances in which the property is available to creditors of the trustee.
- 12.2 Lord Hodgson reported that there was uncertainty concerning the treatment of “permanent endowment” and “special trusts”<sup>956</sup> in insolvency and that the treatment of such property depended on whether the property was held by an individual trustee or by a corporate trustee.
- 12.3 We noted in the Consultation Paper that “permanent endowment” and “special trust” are statutory concepts. The statute in question, the Charities Act 2011, does not explain the insolvency treatment of property falling within the definition of permanent endowment or special trust (or both). We concluded that the availability of any charity property on insolvency (including permanent endowment and special trust property) depended on (a) whether the property was held on trust, and (b) whether the relevant liability was incurred on behalf of that trust. The law gives no special treatment to permanent endowment and special trusts as such, but such property will typically be impressed with a trust which will tend to limit its availability to creditors in the trustee’s insolvency. We also concluded that such property was treated in the same way whether it was held by an individual or by a corporate trustee. Our view remains unchanged following consultation.
- 12.4 We start this chapter by summarising the current law. We then explain the uncertainties and misunderstandings that appear to have arisen, together with our view of the correct position. We conclude that the law is satisfactory and does not require reform, but we do make recommendations that the Charity Commission’s guidance on insolvency be amended to overcome some of the uncertainties and misunderstandings that have arisen. Finally, we discuss some related points raised by consultees.
- 12.5 This chapter deals with complex law and we use various technical terms throughout. Figure 20 gathers together and explains the meaning of those terms.

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<sup>956</sup> See the terminology in Fig 20 below.

**Figure 20: terminology in this chapter**

Trust property

The property held on trust for charitable purposes.

Personal/corporate property

A person/company's personal property owned beneficially.

Trust liability

A liability incurred by a trustee on behalf of a trust.

Personal/corporate liability

A liability incurred by a person/company on their own behalf, and not on behalf of a trust.

Trust creditor

When a trustee incurs a liability on behalf of a trust (a trust liability) – and not for the trustee personally – the creditor is a “trust creditor”.

Personal/corporate creditor

When a trustee incurs a liability in a personal capacity – and not on behalf of a trust – the creditor is a “personal creditor” (in the case of an individual trustee) or a “corporate creditor” (in the case of a corporate trustee). An individual trustee's personal creditor might be a credit card company or the TV licensing authority.

Right of indemnity

A trustee's right to be indemnified from a trust fund in respect of liabilities that were incurred on behalf of the trust (trust liabilities); it comprises the “right to reimbursement” and the “right to exoneration”.

Right to reimbursement

When a trustee has used personal (or corporate) property to discharge a liability that was incurred on behalf of the trust (a trust liability), the trustee is entitled to repayment out of the trust property.

Right to exoneration

When a trustee has incurred a liability on behalf of a trust (a trust liability), the trustee is entitled to discharge that liability directly from the trust property.

Permanent endowment

Property that is held by, or on behalf of, a charity subject to a restriction on being spent.<sup>957</sup>

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<sup>957</sup> Charities Act 2011, s 353(3). See n 610 above. We recommend reform to the definition in Ch 8.

### Special trust

A fund that is held subject to a requirement that it be used for particular purposes within the wider purposes of the charity.<sup>958</sup>

### Restricted fund

A fund which is subject to a restriction on whether or how it can be spent;<sup>959</sup> this would include permanent endowment or a special trust.

### Insolvency

The situation when a debtor is unable to pay debts as they fall due, or when the value of a debtor's liabilities exceed the value of the debtor's assets.<sup>960</sup>

### Bankruptcy

A formal process for the orderly collection of an insolvent individual's property and the distribution of that property to the creditors of the insolvent individual, carried out by a trustee in bankruptcy.

### (Insolvent)<sup>961</sup> liquidation

A formal process for the orderly collection of an insolvent company's property and the distribution of that property to the creditors of the insolvent company, carried out by a liquidator.

## THE CURRENT LAW

12.6 A full explanation of the current law is contained in Chapter 13 of the Consultation Paper. What follows is a summary.

### Bankruptcy and liquidation on insolvency

12.7 Insolvency is the situation where a debtor is unable to pay his or her debts as they fall due, or where the value of the debtor's liabilities exceeds the value of his or her

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<sup>958</sup> See n 611 above.

<sup>959</sup> The term is not defined in the Charities Act 2011. For accounting purposes, the Charities (Accounts and Reports) Regulations 2008, SI 2008 No 629, r 2(1), defines an "unrestricted fund" as any fund "which is to be used, or applied, in any way determined by the charity trustees of a charity for the furtherance of the objects of the charity". Any other fund is a "restricted fund". Further, Charity Commission and Office of the Scottish Charity Regulator, *Statement of Recommended Practice (FRS102)* (effective 1 January 2015), ch 2, identifies two types of restricted fund: (1) a restricted income fund, which must be spent within a reasonable period to further a specific purpose of the charity, and (2) endowment funds which, in turn, can be sub-divided into (a) permanent endowment, which must normally be held indefinitely, and (b) expendable endowment, which the trustees can spend.

<sup>960</sup> Insolvency Act 1986, ss 122 and 267.

<sup>961</sup> Strictly "liquidation" would include the voluntary winding up of a solvent company which results in surplus funds.

assets.<sup>962</sup> On insolvency, the debtor or the creditors may invoke a formal process for the orderly collection of the property of the debtor and the use of that property to pay – so far as possible – the debtor’s debts, on an equal basis<sup>963</sup> according to different categories of debt.<sup>964</sup> For debtors that are individuals this process is known as bankruptcy, and for debtors that are companies it is known as winding up or liquidation. Bankruptcy or liquidation is not the inevitable consequence of insolvency; there are alternative responses such as entering into an individual voluntary agreement (for individuals) or entering into a company voluntary agreement or administration (for companies).<sup>965</sup>

- 12.8 When an individual is made bankrupt the property belonging to the individual, known as his or her “estate”, vests in a trustee in bankruptcy. For this purpose the estate does not include property held by the bankrupt on trust for another,<sup>966</sup> which includes a charitable trust. The responsibilities of the trustee in bankruptcy are to collect the bankrupt’s property, realise it (if necessary) and pay the bankrupt’s creditors in order of their priority.<sup>967</sup>
- 12.9 When a company is liquidated, control of the property of the company goes from the directors of the company to the liquidator.<sup>968</sup> The liquidator is under a duty to collect the company’s assets and apply them in discharge of its liabilities. Property held on trust by the company is not available for distribution amongst its creditors.<sup>969</sup>

## Insolvency in charities

### (1) Insolvency of incorporated charities

- 12.10 If a charity is incorporated and therefore has a separate legal personality, it will be insolvent if its liabilities (corporate liabilities) exceed the value of its assets (corporate property). The insolvency of the directors themselves (whether they are individuals or corporations) will be of no consequence to the charity’s solvency.<sup>970</sup> Nor will the insolvency of the charity have any impact on the directors’ solvency since the directors would not ordinarily be required to contribute towards the incorporated charity’s debts.

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<sup>962</sup> The Insolvency Act 1986 (as amended by the Enterprise Act 2002) lists the situations in which a debtor will be insolvent: ss 122 (circumstances in which a company may be wound up by the court) and 267 (grounds on which a creditor may present a bankruptcy petition to the court).

<sup>963</sup> The traditional term is *pari passu*.

<sup>964</sup> The debts of certain categories of creditor have priority over the debts of others: see n 967 below.

<sup>965</sup> We summarise the alternative approaches in the Consultation Paper, p 199, Fig 12.

<sup>966</sup> Insolvency Act 1986, s 283(3).

<sup>967</sup> There is an order of priority because some will be secured creditors who have the first claim on the asset taken as security, some may be preferential creditors – for example unpaid employees – and the rest will rank equally. There may be nothing for the unsecured creditors; or they may all be paid the same proportion of their debt.

<sup>968</sup> On the liquidation of a charitable company, the purposes of the company change from the charitable purposes set out in the company’s governing document to securing an orderly distribution of the company’s assets to its creditors: *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 1 WLR 877, 881.

<sup>969</sup> *Re Kayford* [1975] 1 WLR 279.

<sup>970</sup> It would have consequences for the director’s ability to continue acting as a company director.

## (2) Insolvency of unincorporated charities

12.11 Strictly speaking, an unincorporated charity cannot become insolvent since it has no legal personality of its own so cannot own property or incur liabilities; it is the trustees of the charity who incur liabilities on behalf of the trust. Nevertheless, where trust liabilities exceed the value of the trust property, we refer to this as the “insolvency” of the trust.

12.12 The insolvency of a charitable trust might lead to the insolvency of one or more of its trustees since the outstanding trust liabilities (after trust property has been used to discharge trust liabilities) will fall on the trustees. If trustees have insufficient personal/corporate property to discharge those liabilities together with their own personal/corporate liabilities then the trustees will be insolvent.

### Availability of trust property to creditors

12.13 This chapter is concerned with the availability of trust property to creditors. The focus is therefore on the insolvency of a *trustee of a charitable trust*.<sup>971</sup> Such a trustee may be an individual or a corporate trustee. The trustee’s insolvency might be caused by:

- (1) the insolvency of the trust (when the value of the trust liabilities exceeds the value of the trust property);
- (2) the insolvency of the trustee in respect of personal/corporate debts (when the value of the personal/corporate liabilities exceeds the value of the personal/corporate property); or
- (3) a combination of the two.

### Insolvency of a trustee of a charitable trust

#### Personal/corporate property

12.14 When an individual trustee of a charitable trust is insolvent, his or her personal property is available for distribution to both personal creditors and trust creditors. Similarly, when a corporate trustee of a charitable trust is insolvent, its corporate property is available for distribution to both corporate creditors and trust creditors.

#### Trust property

12.15 When a trustee (individual or corporate) is insolvent, the general rule is that trust property is not available to the trustee’s creditors.<sup>972</sup>

12.16 A trustee, however, has a right to be indemnified from a trust in respect of liabilities that were incurred on behalf of the trust (trust liabilities).<sup>973</sup> The trustee’s creditors can be

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<sup>971</sup> We are not concerned with the insolvency of an incorporated charity (assuming it does not hold trust property), when the charity’s own assets (corporate property) will be available to discharge its liabilities (corporate liabilities). As explained above, the directors of the incorporated charity would not ordinarily be required to contribute towards the incorporated charity’s debts.

<sup>972</sup> For individual trustees: Insolvency Act 1986, s 283(3); for corporate trustees: *Re Kayford* [1975] 1 WLR 279. See paras 12.8 and 12.9 above.

<sup>973</sup> See Consultation Paper, paras 13.35 to 13.42.

entitled to share in the proceeds of realising the trustee's right to be indemnified from the trust.

12.17 There are two rights of indemnity:

- (1) the right to reimbursement arises where the trustee has discharged a trust liability using his or her own money and entitles the trustee to repayment out of the trust property;<sup>974</sup> and
- (2) the right to exoneration entitles the trustee to discharge a trust liability directly from the trust property.<sup>975</sup>

12.18 In insolvency the right to reimbursement for trust liabilities is realisable for the benefit of both personal/corporate creditors and trust creditors.<sup>976</sup>

12.19 The right to exoneration for trust liabilities, however, is available only for the benefit of trust creditors.<sup>977</sup>

12.20 The creditors' entitlement to share in the proceeds of the rights of indemnity is parasitic on the trustee's right; if the right has been excluded by the trust deed or if the trustee has lost the right – for example, owing to a prior breach of trust – then the creditors will have no claim.<sup>978</sup>

12.21 The position is summarised in Appendix 8, Figures 1 and 2.

12.22 It is possible for the property of a single charity to be held in multiple trust funds by the same trustees (though the creation of an additional trust fund may give rise to a new and distinct charity as a matter of charity law). A trustee who manages multiple trust funds will usually have separate indemnities out of each fund. In the trustee's insolvency the right to reimbursement from any one fund can be realised for the benefit of all the trustee's creditors, including creditors whose liabilities were incurred on behalf of another fund, but the right to exoneration from the fund is available only for the benefit of those creditors whose liabilities were incurred on behalf of that fund.<sup>979</sup>

12.23 The position is summarised in Appendix 8, Figure 3.

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<sup>974</sup> Trustee Act 2000, s 31(1)(a).

<sup>975</sup> Trustee Act 2000, s 31(1)(b). There are ancillary rights of retention and realisation: *Lewin on Trusts* (19<sup>th</sup> ed 2014) para 21-043.

<sup>976</sup> *Lewin on Trusts* (19<sup>th</sup> ed 2014) para 22-041; *Re Suco Gold (in liquidation)* (1983) 33 SASR 99 (Supreme Court of South Australia); Consultation Paper, paras 13.45 and 13.52.

<sup>977</sup> *Re Richardson (ex parte Governors of St Thomas's Hospital)* [1911] 2 KB 705; *Re Suco Gold (in liquidation)* (1983) 33 SASR 99 (Supreme Court of South Australia); *Lewin on Trusts* (19<sup>th</sup> ed 2014), para 22-041; and Consultation Paper, para 13.46 to 13.48, and 13.53.

<sup>978</sup> Consultation Paper, paras 13.39 and 13.40.

<sup>979</sup> *Fraser v Murdoch* (1881) 6 App Cas 855; *Hardoon v Belilios* [1901] AC 118, 123 to 124; Consultation Paper, paras 13.42, 13.49 and 13.54. The trustees might, however, have an express power to indemnify themselves from any assets of the charity, regardless of which trust fund they were incurred on behalf of.

12.24 It goes without saying, therefore, that trustees of charities with complex property-holding arrangements and their creditors should take care to ensure that they understand in what capacity trustees incur liabilities.

#### Summary

12.25 On insolvency, the key questions are:

- (1) whether the insolvent person holds property on trust;
- (2) if so, whether there is a single trust or multiple trusts; and
- (3) if there are multiple trusts, on behalf of which trust each liability was incurred.

12.26 Property that is not held on trust (that is, it is personal or corporate property) can be distributed to all of the insolvent person's creditors.

12.27 If property is held on trust, then it can still be distributed:<sup>980</sup>

- (1) to all creditors (both personal/corporate creditors and trust creditors) in so far as the trustee has a right to reimbursement for trust liabilities; and
- (2) to trust creditors (but not personal/corporate creditors) in so far as the trustee has a right to exoneration for trust liabilities.

12.28 If there is more than one trust:<sup>981</sup>

- (1) the right to reimbursement and the right to exoneration can only be exercised against the specific trust on behalf of which the liability was incurred; and
- (2) the proceeds of the right to reimbursement can be distributed to all creditors (both personal/corporate creditors and trust creditors); but
- (3) the proceeds of the right to exoneration can only be distributed to trust creditors whose debt was incurred on behalf of the specific trust.

12.29 Our summary above sets out the general legal principles governing the availability of trust property when a trustee is insolvent. As the CLA pointed out, the availability of an indemnity in any given case "is very much dependent on the particular circumstances".

## UNCERTAINTIES AND MISUNDERSTANDINGS

### Permanent endowment, special trusts and restricted funds

12.30 Lord Hodgson reported that there was uncertainty concerning the treatment of permanent endowment and special trusts in insolvency.<sup>982</sup> In the Consultation Paper, we said that property that falls within the statutory definition of "permanent endowment"

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<sup>980</sup> Subject to any express terms in the trusts affecting the trustees' right to indemnity.

<sup>981</sup> Again, subject to any express terms in the trusts affecting the trustees' right to indemnity.

<sup>982</sup> Hodgson Report, Appendix A, para 7.



or “special trust”, or both, is not accorded any special treatment in insolvency.<sup>983</sup> No consultee disagreed with this view. We remain of the view that the mere fact that property is classified as “permanent endowment” or a “special trust” says nothing about how it is treated on insolvency.

12.31 In Chapter 8, we concluded that the statutory classification of property as “permanent endowment” will not provide conclusive answers to questions about whether permanent endowment always has particular characteristics.<sup>984</sup> In a similar vein, the statutory classification of property will not reveal the answer to the three key questions in paragraph 12.25 above.<sup>985</sup> Having said that, the existence of a restriction on spending the property (making it permanent endowment), or a requirement that the property be applied only for special purposes of the charity (making it a special trust), is often a circumstance from which to infer the existence of a trust. But, as we concluded in Chapter 8, the mere fact that property falls within the definition of “permanent endowment” does not necessarily mean that it is held on trust.<sup>986</sup> Accordingly, if property falls within the statutory definition of permanent endowment or a special trust, that might indicate the answer to questions (1) and (2) in paragraph 12.25 above but it will not be conclusive.

12.32 The same is true of any “restricted fund”.<sup>987</sup> A restricted fund might also amount to a separate trust. But the mere fact that it is so classified says nothing about how it is treated on insolvency.

### Individual and corporate trustees

12.33 Lord Hodgson suggested that the availability of permanent endowment to meet the liabilities of an insolvent trustee depended on whether the trustee is an individual or a charitable company.<sup>988</sup> In the Consultation Paper, we disagreed with that view. The law does not distinguish between individual trustees and corporate trustees in relation to the availability of trust property to the insolvent trustee’s creditors. Consultees agreed with our analysis of the law.

12.34 The Charity Commission reported that there was some uncertainty as to whether or not a trust fund comprising permanent endowment is a distinct charity. It said that the answer may differ depending on whether the trustee is an individual or a charitable company, and that the answer will determine the availability of the fund to the trustee’s creditors in insolvency. The Charity Commission’s view is that where *individual trustees* of a charitable trust hold permanent endowment and unrestricted property, there is only one charity. Conversely, when a *charitable company* holds property on trust as

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<sup>983</sup> Consultation Paper, para 13.59.

<sup>984</sup> See paras 8.11 to 8.25 above.

<sup>985</sup> Charities Act 2011, s 353(3), which defines permanent endowment, does not refer explicitly to trusts. Nor is a special trust necessarily created by way of trust.

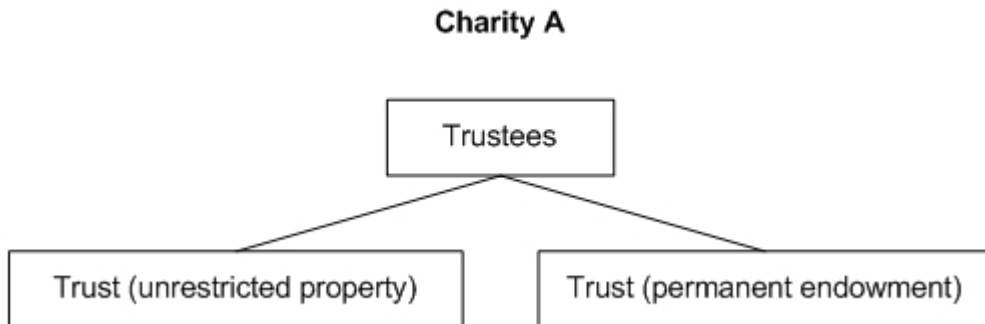
<sup>986</sup> See para 8.17 above.

<sup>987</sup> Bates Wells Braithwaite noted that uncertainties about whether permanent endowment and special trust property are held on trust apply equally to restricted funds. The SORP defines “restricted funds” as including special trusts, permanent endowment and expendable endowment: see Fig 20 above.

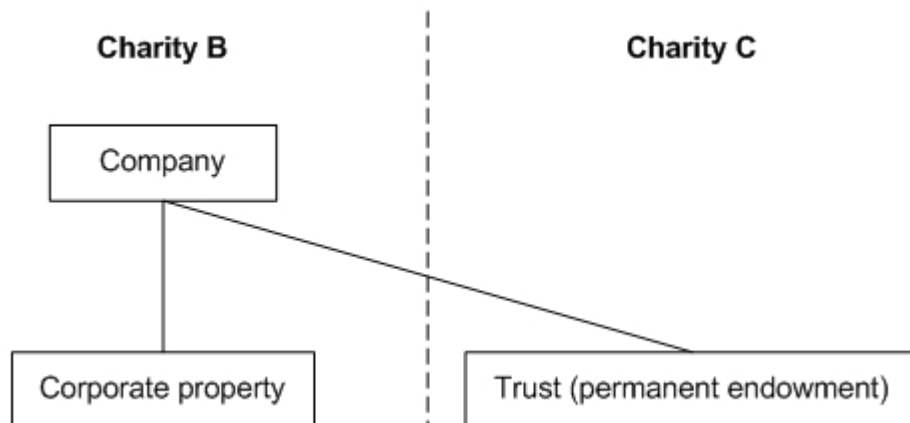
<sup>988</sup> Hodgson Report, Appendix A, para 7; Consultation Paper, paras 13.62 to 13.70.

permanent endowment, the company and trust are treated as two distinct charities: see Figure 21.

**Figure 21: permanent endowment as a distinct charity**



Charity A is an unincorporated charity, comprising two distinct trust funds applicable for identical purposes. One of the trust funds is subject to a restriction on being spent making it permanent endowment. The Charity Commission said that “if one views the permanent endowment restriction as an administrative restriction, as in *Re Laing Trust*,<sup>989</sup> there would seem little reason not to treat the two trusts as one charity if they are for identical charitable purposes”.



Charity B is a charitable company. The company is the outright owner of the company property, which is applicable for the charitable purposes stated in its articles of association. The company holds a trust of permanent endowment as corporate trustee. The income from the permanent endowment is applicable for the company’s purposes generally. In this scenario the Charity Commission regards the trust as a separate charity, Charity C.<sup>990</sup>

<sup>989</sup> [1984] Ch 143.

<sup>990</sup> See paras 8.20 and 8.21 above.

12.35 The Charity Commission said that it is unsure about the implications that the “distinct charities” analysis has for the insolvency treatment of the property in question. In its guidance (“CC12”)<sup>991</sup> it takes the view that if there is only one charity, the permanent endowment would be available for the debts of the charity if the unrestricted property is insufficient to meet them. But if there are two charities, the circumstances in which the permanent endowment may be available for the debts of the other charity will be more limited. In its consultation response, however, the Commission said:

We appreciate that it is trust law that determines the issue of liability so that whether there is one or two charities may be regarded as irrelevant to this issue where there is trust property held on different trusts.

12.36 We agree with what the Charity Commission said in its consultation response. We note that its response is not consistent with the approach suggested in CC12. To the extent that they conflict, we disagree with the approach in CC12.

12.37 The suggestion that a trust of permanent endowment is treated differently depending on whether the trustee is an individual or a company might originate from the Charity Commission’s view that the permanent endowment of a corporate charity is a distinct charity; by reference to Figure 21 above, the assets of Charity C are not available to discharge the liabilities of Charity B. Whether or not permanent endowment of a corporate charity is a distinct charity as a matter of charity law<sup>992</sup> has no bearing on its availability in the trustee’s insolvency. The question is not whether there are distinct charities as a matter of charity law, but whether there are distinct trusts as a matter of trust law (and, if so, whether liabilities were incurred on behalf of each trust).<sup>993</sup> The availability of permanent endowment therefore does not depend on whether the permanent endowment is a distinct charity.

### Charity Commission guidance

12.38 CC12 addresses the issue of how particular funds can be used by a charity to meet its liabilities. In relation to unincorporated charities, the guidance states that:

A trustee is entitled to pay out of (or be reimbursed from) the charity’s funds any expenses that have been properly incurred on behalf of the *charity*. In the case of an unincorporated charity, this may mean that permanent endowment or restricted funds of that charity could be used to cover the liabilities of the charity.<sup>994</sup>

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<sup>991</sup> Charity Commission, *Managing a charity’s finances: planning, managing difficulties and insolvency* (CC12) (January 2016), section 3.3, available at <https://www.gov.uk/government/publications/managing-financial-difficulties-insolvency-in-charities-cc12>. We refer to this Guidance as “CC12”.

<sup>992</sup> There is no authority on the point. Fig 21 demonstrates the Charity Commission’s view, which – consultation revealed – was widely held. As discussed in Ch 8, this has the result in practice of making it easier for a charitable company than a trust to use the ss 275 and 281 powers in respect of permanent endowment.

<sup>993</sup> If, as noted in n 979 above, trustees have an express indemnity from any assets of “the charity”, then the question of whether or not there are distinct charities would be relevant.

<sup>994</sup> CC12, section 3.3.

12.39 We would make the following comments on that guidance:

- (1) Section 31 of the Trustee Act 2000 refers to rights of indemnity in respect of liabilities incurred on behalf of the *trust*, not on behalf of the *charity*.<sup>995</sup> One charity can comprise several trusts.<sup>996</sup> In general, the rights of reimbursement and exoneration can only be exercised against the trust in relation to which the liability was incurred. The guidance might suggest that those rights can be exercised against any trust fund of the charity.
- (2) The right of exoneration can only be exercised against a trust for the benefit of a creditor whose debt was incurred on behalf of that trust. The guidance implies that the right can be exercised against one trust fund to discharge liabilities incurred on behalf of another trust fund.
- (3) Permanent endowment or restricted funds that are held on trust are therefore:
  - (a) available to any creditor of the trustee, in so far as the trustee has a right to reimbursement from the trust fund; and
  - (b) only available to trust creditors whose debt was incurred on behalf of that trust, in so far as the trustee has a right to exoneration from the trust fund.

12.40 In relation to charitable companies, CC12 states that:

A charitable company cannot hold permanent endowment as part of its corporate property. However, a charitable company can act as a corporate trustee of a permanently endowed charity. If the company is facing insolvency, these permanently endowed funds (and any other funds held on special trusts) would not normally be available as part of the company's corporate property to settle debts not relating to the permanent endowment or special trusts.<sup>997</sup>

12.41 We would comment as follows.

- (1) The guidance does not state that the corporate trustee's right of reimbursement can be exercised against a trust fund (including permanent endowment) for the benefit of all creditors of the trustee.
- (2) Even if a charitable company always holds permanent endowment on trust,<sup>998</sup> the Commission has not added that debts that *do* relate to permanent endowment may be settled from it (through the right of exoneration). As explained above, this may give the impression that it is generally more difficult for creditors to have recourse to permanent endowment where it is held on trust by a charitable

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<sup>995</sup> See para 12.17 above.

<sup>996</sup> See, for example, Appendix 8, Fig 3. Different trusts might comprise different charities. But the mere fact that there are different trusts does not necessarily mean that each is a different charity; one charity (as a matter of charity law) can comprise multiple trusts.

<sup>997</sup> CC12, section 3.3.

<sup>998</sup> See paras 8.17 to 8.19 above.

company as opposed to an individual. In fact, as we have seen, the law makes no such distinction.

12.42 These two sections of CC12 therefore have a different emphasis, do not provide a complete explanation and have the potential to mislead. The overwhelming majority of consultees agreed with our provisional proposals that CC12 be amended to address these points.

12.43 We acknowledge that insolvency is a complex matter so there is a limit to what can be achieved by guidance alone. While guidance may usefully set out the legal rules, the application of those rules to the facts of any given case is usually a matter for specialist advice.<sup>999</sup> Concerns were also expressed about increasing the length and complexity of CC12.<sup>1000</sup> We agree that any revisions to CC12 must be comprehensive without being incomprehensible.

12.44 We see the importance of clear guidance on the availability of trust property in insolvency for the benefit of charity trustees and we have concluded that there is scope for clarification of CC12.

**Recommendation 36.**

12.45 We recommend that the guidance of the Charity Commission in *Managing a charity's finances* (CC12) be revised:

- (1) so as to make it clear that the availability of trust property, including trust property that falls within the statutory definition of “permanent endowment”, “special trust” or “restricted funds”, to meet the liabilities of an insolvent trustee is no different whether the trustee is an individual or a charitable company; and
- (2) to reflect more fully and accurately the law governing the exercise of trustees' rights of indemnity from trust property for the benefit of the creditors of the trustee, in particular in respect of permanent endowment, special trusts and restricted funds.

**IS THE LAW SATISFACTORY?**

12.46 We asked consultees whether the law relating to the availability of permanent endowment and special trusts to the creditors of an insolvent trustee is satisfactory.<sup>1001</sup> Most consultees expressed the view that there was no need for reform of the law. Some thought that there were aspects of the law that were not well understood by trustees and ought to be clarified; we comment on those points below.

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<sup>999</sup> As noted by the CLA and the Charity Commission for Northern Ireland.

<sup>1000</sup> Stewardship.

<sup>1001</sup> Consultation Paper, para 13.76.

12.47 One consultee tentatively suggested that permanent endowment should be given special protection so that it is not be available to a trustee's creditors.<sup>1002</sup> When permanent endowment is held on trust, it is already protected in that it is only available to creditors indirectly through the trustees' rights of indemnity, and even then only if the liability was incurred on behalf of the trust. If a liability has been incurred on behalf of a permanently endowed trust, we see no reason why the endowment should not be available to meet that liability. We do not think that a trust of permanent endowment, as compared with other trust property, warrants special protection from creditors.

12.48 There might be scope for a wider review of insolvency law, including consideration of the availability of trust property on insolvency. There are some uncertainties about how the rights of indemnity should be realised on insolvency.<sup>1003</sup> This might be suitable for a future Law Commission project, but our project is limited to charity law and we did not seek views on reform of insolvency law generally. We have concluded that, as regards its application to charities, the law governing the availability of permanent endowment and special trust property on insolvency is satisfactory and we make no recommendations for its reform.

#### **FURTHER POINTS RAISED BY CONSULTTEES**

12.49 Consultees raised additional points concerning insolvency which, on analysis, revealed a desire for guidance as to how the law applies in particular cases rather than suggestions for law reform.

#### **Applying the law to the facts of individual cases**

12.50 Consultees raised questions about (1) when property is held on trust, and (2) when a given liability is incurred on behalf of that trust. To determine the existence or not of a trust, it is necessary to apply rules of trust law. The classification of property as a "special trust" or as "permanent endowment" under the Charities Act 2011 will not provide the answer.

12.51 As for (2), whether a liability incurred by a trustee (whether an individual or corporate trustee) was incurred on behalf of the trust (and, when there are multiple trusts, on behalf of which trust) will depend on the facts. The trustee and creditor might have been clear about the capacity in which the trustee was acting. But in many cases this will not be clear.

12.52 In response to this problem, two consultees<sup>1004</sup> proposed the introduction of a statutory presumption as to when liabilities incurred by a corporate trustee of a charitable trust are to be treated as trust liabilities.

12.53 We acknowledge that a statutory presumption could bring a degree of added clarity in some cases, but it could also give rise to difficult questions as to when the presumption is rebutted; to that extent, any uncertainty is simply shifted to a different stage of the enquiry. It would also be difficult for a statutory presumption to address complicated factual situations; for example, where there are multiple trusts, would the trustee be

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<sup>1002</sup> Prof Duncan Sheehan.

<sup>1003</sup> See Appendix 8, Fig 2, n 1214 and 1215.

<sup>1004</sup> The Independent Schools Council and Veale Wasbrough Vizards LLP.

presumed to be acting on behalf of every trust? We think that the capacity in which a liability is incurred is an issue that should in most cases be dealt with by creditors exercising due diligence in enquiring into (a) the property holding affairs of the charity and (b) the trusts on behalf of which the trustees are acting.<sup>1005</sup> Moreover, we see no justification for changing the law with respect to corporate trustees of charitable trusts while leaving untouched the law that applies to corporate trustees of other trusts. On balance, therefore, we do not think that the law in this area requires change.

12.54 Ultimately, the answer to the questions in paragraph 12.25 above will depend entirely on the particular facts of a given case. Moreover, the answer will often not be obvious, since settlors, trustees and creditors might not have applied their minds to these questions and any available evidence might be contradictory or inconclusive. But we do not think that this is a problem that can be solved by law reform. The outcome of any given case should depend on the facts. Any blanket rule imposed by law reform would risk inappropriate outcomes in particular cases and would override the law of what constitutes a trust (in respect of charitable trusts).

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<sup>1005</sup> We accept that this argument does not apply to involuntary creditors, for instance tort claimants.

## Chapter 13: Charity names

### INTRODUCTION

- 13.1 In this chapter we make recommendations to enhance the powers of the Charity Commission to require a charity to change its name. The adoption by a charity of a name that is similar to another charity's name or is offensive can lead to the public being misled, donations mistakenly being made to the wrong institution, and reputational damage to individual charities and to charities generally. It is therefore important for the Charity Commission to have clear and effective powers in those rare cases where a charity adopts an inappropriate name.<sup>1006</sup> In such cases, the Charity Commission has a power to direct a charity to change its name on any of the five grounds listed in section 42 of the Charities Act 2011.
- 13.2 The first ground applies only to registered charities and can be exercised when the Commission is of the opinion that the name of the registered charity "is the same as", or is "too like", the name of any other charity (whether registered or not). The primary purpose behind this ground is to avoid donors and the general public mistaking one charity for another. The risk of confusion will be particularly high where a charity adopts a name that is the same as, or similar to, the name of a highly prominent charity. This risk is not peculiar to registered charities and we therefore recommend that the power be exercisable against any registered or unregistered charity. Similarly, the powers are not available in respect of some exempt charities and we recommend that they be extended to all exempt charities.
- 13.3 At present, the Charity Commission does not regard itself as capable in law of refusing or delaying an application for an institution to be registered as a charity on the basis that the name would infringe section 42.<sup>1007</sup> Nor, in its view, can the Commission postpone entering the new name of a registered charity on the register pending the resolution of a section 42 issue. The current practice is to ask the institution voluntarily to change its name and in most cases it is willing to do so. If the institution refuses, the Commission can issue a formal direction requiring a change of name, but it cannot cite an infringement of section 42 as a reason for refusing or delaying an application for registration or the entry of a new name in the register. We conclude that this is unsatisfactory; inappropriate names are entered on the register which can undermine public trust and confidence in charities and it creates administrative inconvenience for the Charity Commission. We recommend that the Commission should have a power to delay registration pending resolution of a concern about a charity's name, so that infringing names do not have to be entered on the register during that process. We do not, however, recommend that the power should extend to an outright refusal to register an institution or a change of name.

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<sup>1006</sup> The Charity Commission reports that, in practice, charities' names rarely cause problems because they are usually inoffensive and sufficiently different from other charities' names, so there is no risk of them confusing or misleading the public: Charity Commission, *OG330 Names of Charities* (August 2015), para B2.2, available at <http://ogs.charitycommission.gov.uk/g330a001.aspx>. We refer to the guidance as "OG330"

<sup>1007</sup> Unless the institution is applying for registration as a CIO: Charities Act 2011, s 208; see para 13.16 below.



## REQUIRING A CHARITY TO CHANGE ITS NAME

- 13.4 The names of all charities,<sup>1008</sup> regardless of their legal form, are governed by section 42 of the Charities Act 2011. Charities that are companies are also subject to the rules governing company names in the Companies Act 2006. We consider both regimes below.
- 13.5 Before doing so, we note the distinction drawn by the Charity Commission between the following types of name.
- (1) A “formal name”, or “main name”: the full official name of the charity which appears in its governing document, or which the charity has otherwise formally adopted.
  - (2) A “working name”: a name that a charity may use for its convenience when it carries out its business, for example in fundraising, publicity, advertising and trading.
- 13.6 All charities have a formal name, and some will have one or more working names. For example, the “RSPCA” is the working name of the Royal Society for the Prevention of Cruelty to Animals. We discuss the significance of this distinction below.<sup>1009</sup>
- 13.7 Unless otherwise stated, references in this chapter to the name of a charity should be treated as references to its formal name.

### Section 42 of the Charities Act 2011

- 13.8 The Charity Commission has a power, under section 42(1) of the 2011 Act, to give a direction requiring the name of a charity to be changed, within such period as is specified in the direction, to such other name as the charity trustees may determine with the approval of the Commission. The power may be exercised on the specific grounds provided by section 42, which is quoted in Figure 22.<sup>1010</sup>

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<sup>1008</sup> Save for some exempt charities: see para 13.11 below.

<sup>1009</sup> Paras 13.24 to 13.29 below.

<sup>1010</sup> Charities Act 2011, s 42(2).

## Figure 22: section 42 grounds

A section 42 direction may be given to a charity if:

- (1) it is a registered charity and its name (“the registered name”) –
  - (a) is the same as, or
  - (b) is in the opinion of the Commission too like,  
the name, at the time when the registered name was entered in the register in respect of the charity, of any other charity (whether registered or not) (“ground (a)”),<sup>1011</sup>
- (2) the name of the charity is in the opinion of the Commission likely to mislead the public as to the true nature of –
  - (a) the purposes of the charity as set out in its trusts, or
  - (b) the activities which the charity carries on under its trusts in pursuit of those purposes (“ground (b)”),<sup>1012</sup>
- (3) the name of the charity includes any word or expression for the time being specified in regulations made by the Secretary of State and the inclusion in its name of that word or expression is in the opinion of the Commission likely to mislead the public in any respect as to the status of the charity (“ground (c)”),<sup>1013</sup>
- (4) the name of the charity is in the opinion of the Commission likely to give the impression that the charity is connected in some way with Her Majesty's Government or any local authority, or with any other body of persons or any individual, when it is not so connected (“ground (d)”),<sup>1014</sup> or
- (5) the name of the charity is in the opinion of the Commission offensive (“ground (e)”).<sup>1015</sup>

13.9 Ground (a) only applies to registered charities, and a direction on this ground must be given within 12 months of the registered name being entered in the register.<sup>1016</sup> Grounds (b) to (e) apply to both registered and unregistered charities, and there is no time limit for exercising the power.

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<sup>1011</sup> See further OG330, paras B6 to 7 and D1 to 3.

<sup>1012</sup> See further OG330, paras B8 to 9.

<sup>1013</sup> See further OG330, para B10. See the Charities (Misleading Names) Regulations 1992 (SI 1992 No 1901), which were made under s 4 of the Charities Act 1992.

<sup>1014</sup> See further OG330, paras B11 and D2 to 3.

<sup>1015</sup> See further OG330, para B12.

<sup>1016</sup> Charities Act 2011, s 42(3).

13.10 If charity trustees fail to comply with a direction under section 42, the Charity Commission may apply to the High Court which can exercise the powers that would have been available had the trustees disobeyed a court order (namely committal for contempt of court).<sup>1017</sup> In addition, the Charity Commission may open an inquiry into the charity under section 46. Once an inquiry has been opened, if it is found that there has been any “misconduct or mismanagement in the administration of the charity”<sup>1018</sup> the Commission can take measures including the suspension of charity trustees and the appointment of an interim manager.

13.11 Section 42 applies to some, but not all, exempt charities.<sup>1019</sup> When it does apply, the Charity Commission is required to consult with an exempt charity’s principal regulator before exercising the power.<sup>1020</sup>

13.12 A section 42 direction can be challenged by way of appeal to the Charity Tribunal.<sup>1021</sup>

### Charitable companies

13.13 Charitable companies are required to be registered on the register of companies at Companies House. We explained the rules governing the names of charitable companies in the Consultation Paper.<sup>1022</sup> The Companies Act 2006 regime is broadly similar to section 42 of the Charities Act 2011, but there are two main differences.

- (1) A company cannot be registered by a name which is offensive or is the same as a name already appearing in the register.<sup>1023</sup> By contrast, section 42 of the Charities Act 2011 does not prohibit such a name from being entered on the register and – in the Charity Commission’s view – it does not permit the Commission to refuse to register (or delay the registration of) such a name; it only permits the Charity Commission to direct the charity to change its name.
- (2) A company cannot, without the consent of the Secretary of State, be registered by a name (a) indicating a connection with Government or a local or public authority, or (b) containing sensitive words or expressions specified in regulations,<sup>1024</sup> whereas section 42 of the Charities Act 2011 does not require a charity to obtain the Charity Commission’s prior consent to registration in those circumstances.

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<sup>1017</sup> Charities Act 2011, s 336(1) and 338(2).

<sup>1018</sup> Charities Act 2011, s 76.

<sup>1019</sup> See Consultation Paper, Appendix A.

<sup>1020</sup> Charities Act 2011, s 28.

<sup>1021</sup> Charities Act 2011, s 319 and sch 6. For the difference between appeals to, and reviews by, the Charity Tribunal, see para 15.3 below.

<sup>1022</sup> Consultation Paper, paras 14.27 to 14.31.

<sup>1023</sup> Companies Act 2006, ss 53 and 66.

<sup>1024</sup> Companies Act 2006, ss 54 and 55; the Company, Limited Liability Partnership and Business (Names and Trading Disclosures) Regulations 2015 SI 2015 No 17; the Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2014 SI 2014 No 3140. Some examples of sensitive words and expressions include: “chamber of commerce”, “commission”, “government”, “ombudsman”, “parliamentary”, “Royal” and “tribunal”.

## Delaying or refusing registration when section 42 issues arise

- 13.14 The section 42 power only permits the Charity Commission to direct a charity to change its name (and, where ground (a) is engaged, only a registered charity). The Charity Commission considers itself unable to use section 42 as a reason for (1) refusing to register an institution as a charity, or (2) refusing to register a change of name by a registered charity, on the grounds listed in section 42. Nor does it regard itself as capable of delaying (rather than refusing) (1) an application for registration, or (2) the registration of a change of name, pending the resolution of a section 42 issue.<sup>1025</sup>
- 13.15 This limitation on the scope of the section 42 power is based on the combined effect of sections 29 and 30 of the Charities Act 2011, which require the Charity Commission to keep the register, and require the register to contain the name of every charity that is obliged to be registered,<sup>1026</sup> whether or not its name complies with section 42.
- 13.16 The Charity Commission does, however, have a specific power in relation to CIOs. It may refuse an application for a CIO to be constituted and for its registration as a charity, and it may refuse to register a change of name, if any of the section 42 criteria apply in respect of the name of the applicant.<sup>1027</sup>
- 13.17 In addition, the Charity Commission's current practice is to postpone the entry of an inappropriate name in the register for four weeks to allow an informal resolution of the issue.<sup>1028</sup> It is only if that does not succeed that the Commission will enter the inappropriate name on the register and commence the section 42 process.

## When will the Charity Commission issue a section 42 direction?

- 13.18 If the Commission concludes that it has jurisdiction under section 42 to direct a charity to change its name then it will first ask the charity trustees to make the change voluntarily. In most cases the charity trustees will comply and there will be no need to issue a formal direction.<sup>1029</sup> In the event that they refuse to comply, the Commission may decide to issue a formal direction.<sup>1030</sup>
- 13.19 Concerns about a charity's name are most likely to arise in four situations.

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<sup>1025</sup> OG330, para B5.11. The Charity Commission does, however, refuse to enter offensive names on the register: OG330, para B12.2.

<sup>1026</sup> Under s 30, every charity must be registered in the register unless it is an exempt charity (s 30(2)(a); for the definition of exempt charity see s 22 and sch 3), an excepted charity whose gross income does not exceed £100,000 (s 30(2)(b) and (c)), or a charity (which is not a CIO) whose gross income does not exceed £5,000 (s 30(2)(d)); see para 2.14 above.

<sup>1027</sup> Charities Act 2011, ss 208 and 227.

<sup>1028</sup> OG330, para C2.

<sup>1029</sup> OG330, para B5.11.

<sup>1030</sup> In deciding whether to do so, the Commission considers various factors set out in OG330, para B13.1, summarised in the Consultation Paper, para 14.22.

(1) At the point of registration

13.20 Where an institution applies for registration as a charity,<sup>1031</sup> the Charity Commission will consider whether its name complies with section 42. If the Commission has concerns which cannot be resolved informally, it may issue a section 42 direction. If it is relying on ground (a), it must register the offending charity before issuing a direction, since that ground applies in respect of registered charities only.<sup>1032</sup> As noted above, the Commission considers itself unable to use section 42 as a reason for delaying or refusing the application for registration.<sup>1033</sup>

(2) When a registered charity changes its name

13.21 The charity trustees of a registered charity must notify the Charity Commission when the charity's name is changed,<sup>1034</sup> and the Commission will consider whether the new name complies with section 42. If the Commission has concerns which cannot be resolved informally, it may issue a section 42 direction. As with registration, the Commission regards itself as having no power to refuse or delay the entry of a new name on the register on the basis that it fails to comply with section 42. Its current practice is to enter the new name on the register before issuing a direction.

(3) Change in the circumstances of a charity

13.22 A change in the circumstances of a charity might result in its existing name infringing section 42. For example, if a charity's name has a close connection with its purposes, a change to those purposes might result in the name of the charity no longer being apposite to its work.

(4) Regulatory interest in a dispute between two charities

13.23 A charity might complain to the Charity Commission that another charity's use of a particular name is prejudicial to its reputation or its work. In these circumstances, the Commission may intervene if it has a regulatory interest in the complaint.<sup>1035</sup>

### Working names

13.24 We explained the difference between formal names and working names in paragraphs 13.5 and 13.6 above. Section 42 makes no explicit distinction between the two. The Charity Commission has interpreted it as applying only to formal names, with four consequences.

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<sup>1031</sup> Either when it is established or when it becomes obliged to register (for example, when a charity's annual income increases to more than £5,000 and it is therefore required to register: Charities Act 2011, s 30(2)(d)).

<sup>1032</sup> OG330, para B5.5 and 5.6.

<sup>1033</sup> See para 13.14 above.

<sup>1034</sup> Charities Act 2011, s 35(3)(a).

<sup>1035</sup> For the factors the Commission will consider in deciding whether to issue a s 42 direction, see OG330, para B19.2.

- 13.25 First, when registering a charity, the Commission has an obligation<sup>1036</sup> only to register its formal name and not its working name (though it will commonly choose to do so to promote transparency).
- 13.26 Second, the Commission retains a discretion to refuse to enter a working name into the register, and to remove a working name from the register.<sup>1037</sup>
- 13.27 Third, the Commission can use section 42 to require a charity to change its formal name, but not its working name.<sup>1038</sup>
- 13.28 Fourth, a ground (a) direction can be given if a charity's formal name is similar to another charity's *formal* name; it cannot be given if a charity's formal name is similar to another charity's *working* name. In such a situation, the problem might be solved using ground (d) instead. Ground (d) permits a direction to be given when a charity's formal name gives the impression that the charity is connected with another body when it is not. If a charity's formal name is similar to another charity's working name, it might give the unwarranted impression of a connection with that other charity. In summary, therefore, ground (a) cannot be used to protect another charity's working name, but ground (d) can.<sup>1039</sup>
- 13.29 A refusal by the Charity Commission to enter a working name on the register, or a decision to remove a working name from the register, does not prevent the charity from using that name.<sup>1040</sup> However, in circumstances where a charity has adopted or used a working name in bad faith, for instance to attract funds at the expense of another charity, it is open to the Commission to commence an inquiry into the charity under section 46 of the Charities Act 2011.<sup>1041</sup>

## RECOMMENDATIONS FOR REFORM

### The scope of section 42 directions

#### Directions in respect of working names

- 13.30 Two consultees expressed concern that section 42 directions could only be given in respect of formal names and not working names.<sup>1042</sup> An inappropriate working name could mislead the public as much as an inappropriate formal name. In addition, a charity might change its formal name in response to a section 42 direction but continue to use the objectionable name as its working name. As noted above,<sup>1043</sup> the Charity Commission might take regulatory action against such a charity. It is, however, potentially disproportionate to have to commence a statutory inquiry in such a case; a more proportionate response (at least in the first instance) would be for the Charity

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<sup>1036</sup> See para 13.15 above.

<sup>1037</sup> OG330, paras B3, B18 and E12.

<sup>1038</sup> OG330, para B3.

<sup>1039</sup> OG330, para B5.12.

<sup>1040</sup> OG330, paras E12.2 and 12.3.

<sup>1041</sup> See para 13.10 above.

<sup>1042</sup> Stewardship and Anthony Collins Solicitors LLP.

<sup>1043</sup> See para 13.29 above.

Commission to issue a section 42 direction requiring the charity to stop using a working name.<sup>1044</sup> We agree with these consultees that the Commission should have such a power. If a charity refused to comply with the direction, the Commission could then take enforcement action or open a statutory inquiry.<sup>1045</sup>

13.31 We discussed the extension of section 42 to working names with members of the CLA working party, who expressed mixed views as to whether it was appropriate. Some saw it as a sensible approach. Others saw it as potentially dangerous for three reasons. First, changing a charity's name can be expensive. Second, it might be difficult, in practice, for charities to identify the working names of other charities from the register of charities so as to avoid adopting a formal or working name that might trigger a section 42 direction by reason of being similar to another charity's working name. Third, the period specified in the direction for compliance might be unreasonable.

13.32 In practice, a sensible solution will usually be reached through negotiation between the charity or charities involved and the Commission. As is currently the case, section 42 will be a power of last resort if the issue cannot be resolved informally. Any concerns about the appropriateness of a section 42 direction, including the time specified for compliance, can be raised in a challenge to the direction at the Charity Tribunal.

13.33 As for the practical difficulties of identifying other charities' working names, the problem already potentially arises with ground (d) in section 42, which can be used to require a charity to change a name which is similar to the name of any other organisation (charitable or not) and whether or not the charity was aware of the name of that organisation before it adopted its name. Charities would therefore be well-advised to undertake some basic research before deciding on a (new) name to avoid choosing a name that is similar to another organisation's name.

13.34 Despite the concerns of some members of the CLA, we have concluded that section 42 directions should be extended to allow the Commission to direct a charity to stop using a working name, and we make a recommendation accordingly below.

Scope of ground (a) in section 42

13.35 In the Consultation Paper, we proposed that the Charity Commission's power to issue a section 42 direction relying on ground (a) should be extended to unregistered charities.<sup>1046</sup> We said that the purpose of ground (a) was to ensure that the public did not mistake one charity for another and to prevent disputes between two charities over the use of a particular name. This is not limited to cases where the offending name is being taken up by a registered charity.

13.36 The vast majority of consultees agreed with our proposal on the basis that it would create consistency, improve public trust and confidence in charities, and avoid donations being given to one charity when they were intended for another. Consultees

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<sup>1044</sup> Unlike a direction in respect of a charity's main name, it would not be a direction to *change* its working name since charities are not required to have working names.

<sup>1045</sup> See para 13.10 above.

<sup>1046</sup> Consultation Paper, para 14.37. We noted that this would, at the same time, remove the requirement that any direction under ground (a) must be given within 12 months of the time when the offending name was entered in the register: see para 13.9 above.

said that identical or similar names could be used by unregistered charities just as easily as registered charities, and agreed that the Charity Commission should be able to issue a section 42 direction in both cases.

13.37 Disagreement was based on the view that “common sense and goodwill ought to prevail” and a desire to see deregulation.<sup>1047</sup> We agree that common sense ought to prevail and are reassured that in the vast majority of cases it does.<sup>1048</sup> However, sensible informal resolution of such issues requires the prospect of regulatory sanction in the background. We do not think that extending ground (a) to unregistered charities will increase the regulatory burden on charities; rather, it will create a more rational process and close a potential loophole. We therefore recommend that ground (a) should apply to both registered and unregistered charities.

13.38 We noted above that ground (a) cannot be used where the similarity is with another charity’s working name.<sup>1049</sup> Just as the Charity Commission should be able to issue a section 42 direction to a charity in respect of its formal name or working name,<sup>1050</sup> we think that it should be able to issue a direction on ground (a) where the similarity is with another charity’s formal name or working name. The possibility of misleading the public remains the same in both cases. We make a recommendation accordingly below.

#### Application of section 42 to exempt charities

13.39 The Charity Commission can give section 42 directions to some, but not all, exempt charities.<sup>1051</sup> We said that the problem of charities using a name that is identical or similar to another charity’s name (ground (a)) was not limited to registered charities.<sup>1052</sup> Similarly, the problem could just as well arise in respect of an exempt charity, and the problem might arise under any of the section 42 grounds. We therefore asked consultees whether section 42 should apply to all exempt charities.<sup>1053</sup>

13.40 The majority of consultees thought that section 42 should be extended to exempt charities, saying that this would create consistency and protect public trust and confidence in charities. As the power is “largely to prevent public confusion”, the status of the charity is “irrelevant”.<sup>1054</sup>

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<sup>1047</sup> The Association of Church Accountants and Treasurers.

<sup>1048</sup> See n 1006 above. The Charity Commission says that “Trustees usually agree to change a main name when we tell them why they must, so we only direct trustees to change a name as a last resort.” OG330, para B2.6.

<sup>1049</sup> See para 13.28 above.

<sup>1050</sup> See para 13.30 above.

<sup>1051</sup> See para 13.11 above.

<sup>1052</sup> See para 13.35 above.

<sup>1053</sup> Consultation Paper, para 14.39.

<sup>1054</sup> Charity Law and Policy Unit (University of Liverpool).



13.41 Those who disagreed<sup>1055</sup> thought that regulation of an exempt charity's name should be the exclusive responsibility of the charity's principal regulator. Similarly, the CLA wanted to avoid the powers of the Charity Commission and principal regulator crossing over.

13.42 We agree that, in many cases, an exempt charity's principal regulator will take appropriate action against a charity that adopts an inappropriate name. But we do not agree that overlapping powers would be inappropriate. The Charity Commission protects and regulates charities generally, whereas a principal regulator is only responsible for protecting and regulating particular organisations. It might be that the Charity Commission would have good grounds for issuing a section 42 direction when the principal regulator would, quite properly, decide not to exercise equivalent powers (and *vice versa*). As Francesca Quint pointed out, "there is every likelihood that the exempt charity's principal regulator would not do anything to protect the goodwill of charities outside its own jurisdiction, e.g. HEFCE would only take action to protect [other] English universities etc." Furthermore, the Charity Commission would be required to consult with the principal regulator before issuing a section 42 direction,<sup>1056</sup> and the Charity Commission's power to issue a section 42 direction has already been extended to a number of exempt charities.<sup>1057</sup> We have concluded that it should be extended to all exempt charities.

**Recommendation 37.**

13.43 We recommend that:

- (1) the Charity Commission be empowered to issue a direction, relying on any ground in section 42(2) of the Charities Act 2011, requiring a charity to stop using a working name;
- (2) the Charity Commission be permitted to issue a direction, relying on the ground in section 42(2)(a):
  - (a) against both registered and unregistered charities; and
  - (b) where a charity's (formal or working) name is the same as, or too like, the working name (as well as the formal name) of another charity; and
- (3) the Charity Commission be permitted to issue a direction under section 42 to exempt charities.

13.44 Clauses 27 and 30 of the draft Bill would give effect to this recommendation.

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<sup>1055</sup> Association of Church Accountants and Treasurers, and University of Oxford.

<sup>1056</sup> Charities Act 2011, s 28.

<sup>1057</sup> See Consultation Paper, Appendix A.

## Power to refuse or delay registration

13.45 We noted above that the Charity Commission regards itself as having no power to refuse or to delay an application for registration, or the registration of a change of name, on the basis that a name infringes section 42 (unless the charity is a CIO).<sup>1058</sup> Accordingly, the Charity Commission must register an inappropriate name, and then replace it after completion of the section 42 process. In the Consultation Paper, we said that this undermined the effectiveness of the section 42 power: it is administratively inconvenient for the Commission and the entry of an inappropriate name in the register could damage the reputation of another charity, mislead donors and undermine public trust and confidence in charities.<sup>1059</sup> We provisionally proposed that the Charity Commission be given a power (a) to delay, and (b) to refuse, both an application by an institution for registration and the registration of a change of name on the section 42 grounds.<sup>1060</sup>

13.46 Most consultees agreed with our proposals for the reasons that we gave and for the sake of consistency with CIOs (and the registration of the names of charitable companies at Companies House). Three consultees<sup>1061</sup> disagreed with our proposal, at least in so far as it would permit the Charity Commission to refuse to register an institution as a charity. They said that an institution that is a charity (as defined in the Act) and subject to the requirement to be registered<sup>1062</sup> is entitled to be registered; this obligation and entitlement is not, and should not be, barred by the institution's name. Registration has legal and practical consequences,<sup>1063</sup> but it does not affect the institution's charitable status. Bircham Dyson Bell LLP said that "the entity's name is distinct from its charitable status" and hence its entitlement to be registered.

13.47 Francesca Quint added that our proposal:

would give unconscientious trustees an excuse not to bother to register on the mistaken understanding (not uncommon) that an unregistered charity is not subject to the Commission's jurisdiction. It would also be unjust towards bona fide donors to the charity who could be prevented from getting the benefit of tax relief on their gifts.

13.48 The CLA, with whom Bircham Dyson Bell LLP agreed, advocated creating consistency with CIOs by removing the section 208 power, rather than permitting the Charity Commission to refuse to register charities based on their name. We do not agree that

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<sup>1058</sup> See para 13.14 above.

<sup>1059</sup> Consultation Paper, para 14.41 and 14.42.

<sup>1060</sup> Consultation Paper, para 14.43 and 14.44.

<sup>1061</sup> Francesca Quint, the CLA, and Bircham Dyson Bell LLP.

<sup>1062</sup> Charities Act 2011, s 30 (see n 1026 above). The charity trustees of such a charity have a statutory obligation to ensure that it is registered: s 35.

<sup>1063</sup> It provides institutions with a means to prove that they are genuine charities since there is a conclusive statutory presumption that an institution on the register is a charity: Charities Act 2011, s 37(1). It also provides a route to receiving tax and other advantages; a charity does not need a registered charity number to obtain these advantages, but Lord Hodgson noted the considerable benefits to charities with (and the hurdles faced by those without) a registered number: Hodgson Report, para 5.41. This was the basis for his recommendation that small charities should be permitted to register voluntarily: Hodgson Report, para 5.48 and Recommendation 11.

section 208 should be removed. CIOs, like companies, are created by registration.<sup>1064</sup> Section 208 mirrors the power of the registrar of companies to refuse to register a company if it has an inappropriate name.

13.49 It was also suggested that, rather than refuse registration, the Charity Commission should annotate the register to alert the public to the outstanding issue with the charity's name. The Commission already adopts this approach<sup>1065</sup> and we agree that it should continue.

13.50 The CLA and Bircham Dyson Bell LLP agreed, however, with our proposal to allow the Charity Commission to refuse to register a change of name as the charity would remain registered so it would be clear that the institution had already qualified as a charity.

13.51 Underlying the disagreement in relation to initial registration are different views of the nature and role of the register of charities.

(1) Charitable status is accompanied by an entitlement (and an obligation) to be registered,<sup>1066</sup> and charitable status is not dependent on an institution's name. A power to refuse registration might suggest that registration is a pre-requisite to charitable status and, as such, is a privilege rather than an entitlement. We agree that registration is an entitlement for charities, though we recognise that it brings privileges with it.<sup>1067</sup>

(2) It is important that the register is kept up-to-date with the current name of every registrable charity, but we do not think that this should prevent registration being delayed where there is good reason to do so.

13.52 Scotland and New Zealand treat registration as a privilege since a charity must be refused registration if its name is objectionable. The Scottish Charity Regulator must refuse an application for registration if the organisation's name is the same as, or too like, the name of another charity, likely to mislead the public, or offensive.<sup>1068</sup> Similarly, in New Zealand an organisation cannot be registered if its name is offensive or liable to mislead the public.<sup>1069</sup> By contrast, Northern Ireland (like England and Wales) treats registration as an entitlement; the Charity Commission for Northern Ireland does not have a specific power to refuse to enter an inappropriate name on the register but rather has a power to direct a charity to change its name.<sup>1070</sup>

13.53 We have concluded that the Charity Commission should not have the power to *refuse* an application for registration on the grounds in section 42. We think it would be undesirable for an institution that is a charity and that is registrable as such to be refused registration. The result would be a stalemate; the charity trustees failing to comply with

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<sup>1064</sup> Registration by the Charity Commission of all other charities does not have that effect.

<sup>1065</sup> OG330, para B14.3 and the flowchart at C2.

<sup>1066</sup> If the charity is registrable under s 30.

<sup>1067</sup> See n 1063.

<sup>1068</sup> Charities and Trustee Investment (Scotland) Act 2005, ss 5(2)(a) and 10.

<sup>1069</sup> Charities Act 2005 (New Zealand), ss 13(1)(c) and 15(e).

<sup>1070</sup> Charities Act (Northern Ireland) 2008, s 20.

their obligation to register and the Charity Commission not having a complete register of registrable charities. Similarly, we do not think that the Charity Commission should have a power to *refuse* to register a change of name, since the inappropriate name is, nevertheless, the name of the charity and the register ought to record that fact.

13.54 But we do think that there should be a mechanism to allow section 42 issues to be resolved, without inappropriate names reaching the register during that process. We have concluded that the Charity Commission should have a power to *delay* the registration of a charity, and the registration of a change of name, pending the resolution of a section 42 issue. Such a power would be “less draconian” than a power to refuse registration.<sup>1071</sup> It would be a small but justifiable inroad into the principle that all registrable charities are entitled to be registered. We accept that it will result in the register being slightly out of date; for a relatively short period, some registrable charities will not appear on the register, and some changes of name will not be recorded on the register. In the case of a registration application, it would be possible (but not obligatory) for the Charity Commission to register the charity during the stay, without including the charity’s name, and annotating the register to state that the charity’s name is the subject of a dispute; the charity would be identifiable by its registered charity number. Similarly, in the case of the registration of a change of name, the Commission could annotate the register to state that the charity has changed its name but that the new name is the subject of a dispute; the charity would be identifiable both by its registered charity number and by its previous name.

13.55 As Anthony Collins Solicitors LLP noted, creating a power to delay registration would – in part – formalise the Charity Commission’s existing practice of postponing the entry of an inappropriate name in the register pending informal resolution of the issue.<sup>1072</sup> Our recommendation would, however, go further and permit the Charity Commission to delay entering an inappropriate name into the register pending the resolution of a section 42 process, where informal resolution had not been successful.

13.56 The aim of our recommendation is to facilitate the resolution of a section 42 issue, not to result in stalemate. The Charity Commission should not therefore be permitted to delay registration indefinitely, which would be tantamount to refusing registration. If the section 42 process is unsuccessful in resolving the issue, the Charity Commission should decide whether to take regulatory action (see paragraph 13.10 above). If it does not do so, the charity’s name should be registered.

13.57 The stay should therefore last for the duration of the section 42 direction (which will specify the date by which the charity must change its name) and then for a further period of 60 days to allow the Charity Commission to take action to prevent the inappropriate name from being entered on the register. That period strikes a balance between (a) giving the Charity Commission sufficient time to take action, if it is going to (and keeping the inappropriate name off the register in the meantime), and (b) the right of a registrable charity to be registered.

13.58 The stay should also continue for the duration of any appeal to the Charity Tribunal against the section 42 direction. The Commission might properly decide not to take

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<sup>1071</sup> Charity Commission for Northern Ireland.

<sup>1072</sup> See para 13.17 above.

enforcement action pending the outcome of an appeal against a section 42 direction, and the stay should continue until the appeal is disposed of. Similarly, the stay should continue for the duration of a challenge to any other regulatory action that is taken by the Commission in relation to the section 42 direction. Additionally, if the Commission commences proceedings for contempt of court to enforce a section 42 direction within the 60-day stay, the stay should continue until those proceedings are disposed of. The Commission has no control over the timescale for any of these proceedings; their duration will depend on the timetable set by the Tribunal or court (and, in the case of challenges to the section 42 direction or other enforcement action, will also depend on the actions of the complainant).

## Conclusion

13.59 The view that inappropriate names should not be registered is incompatible with the view that registration is an entitlement for institutions that are charities regardless of their name. We acknowledge that our recommendation amounts to a compromise. We hope that it will create a better process for the resolution of disagreements about a charity's name by giving the Charity Commission sufficient time to take action against the charity without requiring the Commission to enter inappropriate names in the register during that period.

### **Recommendation 38.**

13.60 We recommend that:

- (1) the Charity Commission be given a power to delay the registration of an institution as a charity, and to delay changing a charity's name in the register:
  - (a) during the period for compliance specified in a direction issued under section 42 of the Charities Act 2011; and
  - (b) for 60 days after that date for compliance; and
- (2) the 60 day period should stop running during any period that the following proceedings are ongoing:
  - (a) any challenge to (i) the section 42 direction, or (ii) any enforcement action taken by the Commission in respect of the section 42 direction; and
  - (b) any proceedings for contempt of court in respect of the section 42 direction.

13.61 Clauses 28 and 29 of the draft Bill would give effect to this recommendation.

# Chapter 14: The identity of a charity's trustees

## INTRODUCTION

- 14.1 As explained in Chapter 2, all charities have “charity trustees” who control and manage the charity,<sup>1073</sup> and some – but not all – also have members.<sup>1074</sup> The members of a charity will usually have a role in the selection of the charity trustees.
- 14.2 The Charity Commission has a power to determine the identity of the members of a charity. It has no similar power to determine the identity of the charity trustees of a charity and, in this chapter, we consider whether such a power should be created. We conclude that a slightly different power should be created in respect of trustees, namely a power for the Commission to ratify a charity trustee's appointment or election.

## DETERMINING THE IDENTITY OF A CHARITY'S MEMBERS

- 14.3 Section 111 of the Charities Act 2011 empowers the Charity Commission<sup>1075</sup> to determine who the members of a charity are. The power may be exercised either where a charity applies for its membership to be determined, or where the Charity Commission has commenced an inquiry into a charity.<sup>1076</sup>
- 14.4 The purpose of the Charity Commission's power to determine membership is to facilitate and ensure the proper administration of a charity.<sup>1077</sup> The Charity Commission's guidance suggests that the power would be used in two situations.<sup>1078</sup> First, incomplete membership records can lead to disputes about membership and consequential claims of invalid elections of trustees, so the power can be used to determine who the members are and therefore who is entitled to vote on the election of trustees. Second, the power could be used where the trustees have unreasonably exercised their discretion in admitting or refusing to admit a person as a member. The Commission's guidance suggests that it would go through the process of considering applications for membership and, applying the criteria in the governing document, decide who should be members of the charity, which we describe as a “selection exercise”. But we do not think that section 111 is limited to these two situations; for example, we think that it could be used where a charity seeks ratification of its membership list if there are uncertainties as to whether it is accurate or as to whether individuals qualify for membership.

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<sup>1073</sup> Charities Act 2011, s 177.

<sup>1074</sup> This will usually be the members of an unincorporated association, the members of a CIO or the members (usually guarantors) of a charitable company.

<sup>1075</sup> Or a person appointed by the Charity Commission.

<sup>1076</sup> Charities Act 2011, s 46.

<sup>1077</sup> See the Explanatory Notes to the Charities Act 2006, s 25 which created the power.

<sup>1078</sup> Charity Commission, *OG117-9 Investigations Work – Using Permanent Protective Powers* (August 2017) s D5, para 7, available at <http://ogs.charitycommission.gov.uk/g117a009.aspx>.

## DETERMINING THE IDENTITY OF A CHARITY'S TRUSTEES

14.5 Lord Hodgson recommended that the section 111 power be extended to allow the Charity Commission to determine the identity of a charity's trustees.

It is common to come across charities where the trustee body has been constituted incorrectly for a long period. Nominating bodies may have ceased to exist or may not have exercised their power to nominate for many years. The persons acting as trustees may not know they are trustees. It would be helpful for the Commission to be able to ratify the appointment of such trustees and confirm who the trustees are.<sup>1079</sup>

14.6 In the Consultation Paper, we agreed that a power to determine the identity of a charity's trustees would be helpful and made a provisional proposal accordingly.<sup>1080</sup> We said that a power would allow the Charity Commission to resolve uncertainties as to whether trustees had been properly appointed, and to remedy directly and quickly one of the difficulties that an incomplete or inaccurate record of members creates. This would avoid having to determine the membership under section 111 before an election of trustees can take place.

### Existing ways to deal with uncertainties about the identity of trustees

14.7 When there are uncertainties concerning the identity of a charity's trustees, or when a charity has too few trustees, the charity might be able to resolve the difficulties itself. For example, it might rely on express provisions in the charity's governing document for the appointment or removal of trustees, or on statutory powers.<sup>1081</sup>

14.8 In addition, the Charity Commission has powers which can in some circumstances be used to address uncertainties concerning the identity of trustees, or a lack of trustees:

- (1) in very limited circumstances the Commission can remove a trustee, for example when the trustee is unwilling to act;<sup>1082</sup>
- (2) in slightly less limited circumstances the Commission can appoint trustees, for example if there are no charity trustees, or if there is a single trustee and it is necessary to increase the number of trustees "for the proper administration of the charity";<sup>1083</sup>
- (3) the Commission can make an order authorising someone within the charity (such as the chief executive) to call a trustee election;<sup>1084</sup> or

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<sup>1079</sup> Hodgson Report, Appendix A, para 12.

<sup>1080</sup> Consultation Paper, Ch 15 and para 15.7.

<sup>1081</sup> The trustees of a charitable trust can appoint trustees under the Trustee Act 1925. The members of a charitable company might be able to amend the company's articles to address the particular problem using the statutory amendment powers in the Companies Act 2006: see Ch 4 above.

<sup>1082</sup> Charities Act 2011, s 80(1).

<sup>1083</sup> Charities Act 2011, s 80(2).

<sup>1084</sup> Charities Act 2011, s 105.

(4) the Commission can make a scheme for the administration of the charity.<sup>1085</sup>

14.9 The Commission will only exercise its powers if the charity cannot resolve the difficulties itself, and when it appoints trustees it will appoint the minimum number of trustees who will then be expected to appoint further trustees.<sup>1086</sup>

14.10 If uncertainty concerning the identity of trustees arises as part of a dispute within the charity, the Commission is extremely reluctant to become involved. It expects trustees and members to take legal advice and resolve disputes themselves.<sup>1087</sup>

### Consultation responses

14.11 Most consultees agreed with our proposal to give the Charity Commission a power to determine the identity of the trustees. Two consultees thought that such a power was unnecessary.<sup>1088</sup> One thought that the Commission should be limited to providing guidance on identifying trustees and that providing a determinative conclusion as a matter of law is best left to the courts.<sup>1089</sup> The CLA agreed that the power could help to clarify uncertainties, but they had “strong concerns” about the proposal for the following reasons:

- (1) a determination could vest rights in, and impose liabilities on, a person, and remove equivalent rights and liabilities from another;
- (2) there may need to be a deeming provision to vest rights and liabilities in the individuals who are determined to be the trustees;
- (3) a determination should not be retrospective; and
- (4) an individual should consent to being a trustee before a determination is made.

14.12 In our view, the validity of these concerns depends on the circumstances in which a new power would be used and its scope, which we now turn to consider.

### Circumstances in which a new power would be used

14.13 There is a range of situations in which the Charity Commission could exercise a power to determine the identity of the trustees which can be split, broadly, into three (potentially overlapping) categories. In all cases, the issue is not strictly whether a person is, or should be, a “charity trustee”, since that is merely a statutory label that attaches to the holder of a particular role within each charity (such as a director of a charitable company, or a trustee of a charitable trust). The issue, therefore, is whether a person

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<sup>1085</sup> Charities Act 2011, s 69.

<sup>1086</sup> Charity Commission, *OG510-1 Charity Trustees: Making and Ending Appointments* (November 2016) para B1.

<sup>1087</sup> Charity Commission, *OG565 Disputes in Charities* (December 2013), available at <http://ogs.charitycommission.gov.uk/g565a001.aspx>.

<sup>1088</sup> Colleges of the University of Oxford and Association of Church Accountants and Treasurers.

<sup>1089</sup> University of Oxford.



holds, or should hold, the underlying role in relation to the charity which, in turn, makes them a “charity trustee” within the meaning of the Charities Act 2011.

Determining who the trustees are (“case (1)”)

14.14 The power could allow the Commission to decide, as a finding of fact (just as a court would), on the basis of evidence put before it, who the validly appointed trustees are, or that there are no validly appointed trustees. On occasion, the Charity Commission already has to make this decision as a prelude to exercising other powers,<sup>1090</sup> and it might be helpful for such a decision to be given a statutory basis.

Ratification of an invalid or uncertain trustee appointment or election (“case (2)”)

14.15 If there has been an invalid appointment or election, or if there is uncertainty about whether a person has been properly appointed or elected, the Commission could ratify who the trustees are. The ratification would establish a person as a trustee in the event that he or she had not been properly appointed or elected previously. There might be a dispute in the background, or it might simply be that a person wants confirmation that he or she is a trustee.

A selection exercise (“case (3)”)

14.16 The Charity Commission could go through a process of deciding who the trustees ought to be.

## Conclusions

14.17 In our view, a new power to ratify trustee appointments or elections (case (2)) would be useful. It could help to overcome uncertainties as to whether a particular person was properly elected or appointed and therefore provide practical reassurance to the trustee concerned, the charity itself, and third parties. It could also avoid the costs and delay of having to repeat an election or appointment process.

14.18 We do not think that a power to permit the Charity Commission to make findings of fact (case (1)) should be created. In practice, the need for a decision is likely to arise where there is a dispute about the identity of the trustees between rival factions within the charity, in which case the Commission’s general policy of not becoming involved in disputes within charities means that it is unlikely to intervene. Moreover, the Charity Commission has told us that it would not want a power to make a quasi-judicial decision as to the identity of the trustees, on the basis that such a decision is best left to the courts. There is little point in creating a power that the Commission does not want and would not use.

14.19 Nor do we think that a power to conduct selection exercises (case (3)) should be created. The Commission would be extremely unlikely to exercise such a power since it would be contrary to its practice of leaving charities to make trustee appointments themselves, it could be resource-intensive, and, in any event, the Commission already has powers to appoint trustees if the charity is unable to do so.

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<sup>1090</sup> Charity Commission, *OG565 Disputes in Charities* (December 2013) para B2.6.

## Relationship with section 111

14.20 The Charity Commission's guidance suggests that the section 111 power to determine the identity of the *members* of a charity would be most useful to permit the Commission to carry out a selection exercise (akin to case (3)), and not to make findings of fact or to ratify the membership (akin to cases (1) and (2)). Accordingly, whilst a new power in relation to charity trustees might be seen simply as a logical extension of the section 111 power, such a new power based on case (2) would not do the same job as section 111; the differences between trustees and members mean that the two powers would not in practice be used in analogous situations.

## Effect of exercising the power

14.21 We noted in paragraph 14.11 above the CLA's concerns about the power that we had proposed in the Consultation Paper. As explained, we are now suggesting a more limited power to ratify appointments, and we have concluded that the CLA's concerns do not outweigh the case for creating such a power. In reality, where an individual disputes that he or she is a validly appointed trustee, the Commission will not ratify the appointment against his or her will.<sup>1091</sup> But in any event the CLA's concerns about a person becoming a trustee, or having rights and obligations imposed, against his or her will can be resolved by requiring that person to consent to the Commission ratifying the appointment or election. We agree with the CLA that any ratification should only have prospective effect, though we think it would be helpful for the Commission to be able to ratify previous acts of a person (who at the time may not have been validly appointed or elected) on a case-by-case basis. Finally, we are not convinced that there is any need for automatic vesting provisions, but we think that the Commission should have powers (similarly to when they appoint or remove trustees under section 69 of the Charities Act 2011) to vest property in the trustee whose appointment or election has been ratified.

## Gateways to using the power

14.22 In the Consultation Paper, we said that the Commission should be able to exercise the power (a) on an application by the charity itself; (b) on an application by any person claiming to be a trustee of the charity; and (c) of its own initiative where it has opened an inquiry into the affairs of the charity under section 46 of the Charities Act 2011. The section 111 power can be exercised in situations (a) and (c), and we suggested adding (b) since the power anticipates some uncertainty as to the identity of the charity trustees.

14.23 Some consultees thought the gateway should be wider or narrower. The Colleges of the University of Cambridge suggested that the power should be exercisable on the application of any person. By contrast, the CLA suggested that the power should only be exercisable on the application of a charity or someone claiming to be a trustee, but not following a section 46 inquiry owing to concerns about vesting rights and liabilities in individuals.

14.24 In the light of our conclusions above concerning the circumstances in which the new power would be used, we think that the Charity Commission should be able to exercise the power to ratify an invalid or uncertain appointment on the application of any person. In practice, the applicant is likely to be the individual concerned (that is, the person

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<sup>1091</sup> The Commission has a general policy not to become involved with disputes within charities.

whose appointment is sought to be ratified) or the charity, but in theory it could be any other person. However, the individual concerned should have to consent to the order being made if he or she is not the applicant for the order.

Who should exercise the power?

14.25 A power to ratify invalid or uncertain appointments should, we think, only be capable of being exercised by the Charity Commission. We have therefore concluded that – unlike in section 111 – the Commission should not be permitted to delegate the decision to a third party.

Challenging decisions to exercise, or not to exercise, the power

14.26 Some consultees suggested that a decision by the Charity Commission under the new power should be capable of appeal to the Charity Tribunal (and noted that a decision under section 111 was not subject to such an appeal).<sup>1092</sup>

14.27 We noted the three potential avenues to challenge Charity Commission decisions in Chapter 9, as well as the inconsistency between the different rights of challenge.<sup>1093</sup> Similarly to the power to award an equitable allowance, the power to ratify an appointment is a discretionary power, and a decision to exercise the power or a decision not to exercise the power should not be capable of appeal to the Tribunal.<sup>1094</sup> The question, therefore, is whether those decisions should be capable of review by the Tribunal or judicial review by the court.

14.28 As with the power to award an equitable allowance, it is arguable that the decisions should be capable of review by the Tribunal. However, the most analogous decision to the power to ratify a trustee appointment is the power of the Commission to determine the identity of the charity's members under section 111.<sup>1095</sup> A decision to exercise that power, or to refuse to exercise that power, cannot be challenged in the Tribunal (whether by way of appeal or review) but must instead be challenged by way of judicial review. In Chapter 9 we have noted that Schedule 6, which sets out the challenges that can be made to the Charity Tribunal, is internally inconsistent, but that a review of the Schedule falls outside the terms of reference for this project. We have suggested in the circumstances that the most appropriate approach is to avoid exacerbating internal inconsistencies within the Schedule. Therefore, while we acknowledge that there are competing arguments, we consider that the new power to ratify a trustee appointment should (like the existing power to identify the charity's members) be subject to challenge by way of judicial review.

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<sup>1092</sup> See further Ch 15.

<sup>1093</sup> See paras 9.31 to 9.37 above.

<sup>1094</sup> See para 9.32 above.

<sup>1095</sup> See paras 14.3 to 14.6 and 14.20 above.

**Recommendation 39.**

14.29 We recommend that:

- (1) the Charity Commission be given the power to ratify prospectively the appointment or election of a person to a particular role (which in turn would render them a charity trustee);
- (2) the power should be exercisable only with the consent of the person whose appointment or election is sought to be ratified; and
- (3) a decision to ratify, or not to ratify, an appointment should be subject to challenge by way of judicial review.

14.30 Clause 31 of the draft Bill would give effect to this recommendation.

# Chapter 15: The Charity Tribunal and the courts

## INTRODUCTION

- 15.1 The Charities Act 2006 created the Charity Tribunal to provide a low-cost<sup>1096</sup> and user-friendly means of challenging Charity Commission decisions as an alternative to challenges to the court, which charities rarely embarked upon.<sup>1097</sup> We are not assessing whether the Tribunal's objectives have been achieved.<sup>1098</sup> Rather, we make recommendations on three particular issues relating to the Charity Tribunal that Lord Hodgson identified as creating difficulties for users of the Tribunal, as well as associated points that arose during our examination of them. We look first at the requirement for charities to obtain authorisation before taking "charity proceedings". Next, we examine the ways in which trustees can obtain advance assurance that legal costs they propose to incur in litigation can properly be paid from the charity's funds. We then consider whether it should be possible to suspend Charity Commission decisions pending a challenge in the Charity Tribunal. Finally we look at the procedure by which the Attorney General and Charity Commission can refer questions of charity law to the Charity Tribunal.
- 15.2 The Charity Tribunal became operational in March 2008.<sup>1099</sup> Shortly afterwards, the Tribunals, Courts and Enforcement Act 2007 ("the TCEA 2007") came into force. The TCEA 2007 created a single structure for most tribunals,<sup>1100</sup> divided into the First-tier Tribunal and the Upper Tribunal. The First-tier Tribunal and the Upper Tribunal each have separate chambers covering different subject matters. In September 2009,<sup>1101</sup> the Charity Tribunal's work was transferred to the General Regulatory Chamber of the First-tier Tribunal ("the First-Tier Tribunal (GRC)") and the Tax and Chancery Chamber of the Upper Tribunal ("the Upper Tribunal (TCC)"). We use the term "Charity Tribunal" to

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<sup>1096</sup> The Tribunal is currently free to use, but Government has announced plans to introduce fees. Charities and individuals may be charged up to £600 to bring a case to the Charity Tribunal: R Cooney, "Government plans to press ahead with fees for using the charity tribunal" (Third Sector, January 2016) available at <http://www.thirdsector.co.uk/government-plans-press-ahead-fees-using-charity-tribunal/policy-and-politics/article/1378574>. The Government has said that it will bring forward the statutory instruments to introduce fees as soon as Parliamentary time allows, see: Court and tribunal fees: government response to consultation on further fees (December 2015) Cm 9181, p 17, available at: <https://www.gov.uk/government/consultations/enhanced-fees-response-and-consultation-on-further-fee-proposals>.

<sup>1097</sup> Cabinet Office Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Not-For-Profit Sector* (September 2002) paras 7.69 to 7.80. It was also intended that publication of the Tribunal's decisions would encourage the evolution of charity law: The Draft Charities Bill, Report of the Joint Committee on the Draft Charities Bill (2003-2004) HL Paper 167-1, HC 660-1, para 241 and pp 200 to 201, available at <http://www.publications.parliament.uk/pa/jt200304/jtselect/jtchar/167/167.pdf>. See also A McKenna, "Transforming Tribunals: the reform of the Charity Tribunal by the Tribunals Courts and Enforcement Act 2007" (2009) 11 *The Charity Law and Practice Review*, 1 to 2.

<sup>1098</sup> The Hodgson review broadly assessed the success of the Tribunal: Hodgson Report, ch 7, and para (e) of the terms of reference at p 149.

<sup>1099</sup> When the Charities Act 2006, s 8, came in to force.

<sup>1100</sup> The main exceptions are the Employment Tribunal and the Employment Appeal Tribunal.

<sup>1101</sup> When the Transfer of Functions of the Charity Tribunal Order 2009 SI 2009 No 1834 came in to force.

refer to both the First-tier Tribunal (GRC) and the Upper Tribunal (TCC) when they are exercising the jurisdiction originally conferred by the Charities Act 2006, and the term “charity cases” to refer to cases falling within that jurisdiction.

## THE WORK OF THE CHARITY TRIBUNAL

15.3 There are three types of charity cases that fall within the Charity Tribunal’s remit: see Figure 23.

### Figure 23: cases heard by the Charity Tribunal

#### (1) Appeals and reviews

The Charity Tribunal considers challenges to decisions of the Charity Commission. The Act specifies the decisions that can be challenged. It provides that certain decisions are challengeable by way of appeal, when the Tribunal considers the matter afresh at a re-hearing and makes its own decision, and that other decisions are challengeable by way of review, when the Tribunal considers the way in which the Charity Commission made a decision, applying judicial review principles.<sup>1102</sup>

#### (2) References

The Attorney General, or the Charity Commission (with the consent of the Attorney General), can refer to the Charity Tribunal questions concerning charity law or its application to a particular case.<sup>1103</sup> Two references have been determined by the Charity Tribunal thus far, one concerning the charitable status of independent schools<sup>1104</sup> and the other concerning the charitable status of benevolent funds whose beneficiaries are limited to a particular class.<sup>1105</sup>

#### (3) Transferred applications for judicial review

Applications to the High Court for judicial review of decisions of the Charity Commission can be transferred to the Upper Tribunal (TCC).<sup>1106</sup> This power was exercised to transfer an application by the Independent Schools Council for judicial review against the Charity Commission to the Upper Tribunal (TCC) in order to be heard at the same time as the Attorney General’s reference concerning the charitable status of independent schools.<sup>1107</sup>

<sup>1102</sup> Charities Act 2011, ss 315(2)(a) and 319 to 324, and sch 6. Appeals against orders under s 52 (giving the Charity Commission power to make orders requiring documents to be disclosed) are treated differently: s 320.

<sup>1103</sup> Charities Act 2011, s 315(2)(b) and 325 to 331. References by the Charity Commission must also have “arisen in connection with the exercise by the Commission of its functions”: s 325(1)(a).

<sup>1104</sup> *Independent Schools Council v Charity Commission for England and Wales* [2011] UKUT 421 (TCC).

<sup>1105</sup> *Attorney General v Charity Commission for England and Wales* [2012] UKUT 420 (TCC).

<sup>1106</sup> Senior Courts Act 1981, s 31A. Such applications cannot be heard by the First-tier Tribunal (GRC).

<sup>1107</sup> *R (Independent Schools Council) v Charity Commission for England and Wales* [2010] EWHC 2604 (Admin), [2011] ACD 2. We consider this further below in the context of the Tribunal’s powers when determining a reference.

15.4 There is generally no “costs-shifting” within the Charity Tribunal: each party must bear the legal costs it incurs (if any) in pursuing a case. There are limited exceptions to this rule, principally that the Tribunal can make a costs order if it considers that a party has acted unreasonably in bringing, defending or conducting the proceedings.<sup>1108</sup> This power has not been exercised by the Tribunal to date, but the Charity Commission has indicated that it is considering starting to seek costs orders against charities from the Tribunal in respect of unsuccessful challenges.<sup>1109</sup>

## A PERMISSION FILTER FOR COURT AND TRIBUNAL PROCEEDINGS

### Court proceedings

15.5 Section 115 of the Charities Act 2011 prevents “charity proceedings” from being pursued, whether by or against a charity, unless authorisation has been obtained from the Charity Commission or the High Court.<sup>1110</sup> The purpose of this restriction is “to prevent charities from frittering away money subject to charitable trusts in pursuing litigation relating to internal disputes”.<sup>1111</sup>

#### Figure 24: the definition of “charity proceedings”

Section 115 defines “charity proceedings” as:

Proceedings in any court in England or Wales brought under –

- (a) the court’s jurisdiction with respect to charities, or
- (b) the court’s jurisdiction with respect to trusts in relation to the administration of a trust for charitable purposes.<sup>1112</sup>

15.6 Although not entirely clear from the words themselves, the definition distinguishes internal disputes within the charity (which are charity proceedings)<sup>1113</sup> from disputes

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<sup>1108</sup> Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009, r 10(1)(b). The Tribunal may also make a wasted costs order where a party’s representative has behaved improperly, unreasonably or negligently (r 10(1)(a)) and it may make a costs order against the Charity Commission when it considers that the decision subject to challenge was unreasonable (r 10(1)(c)). Similar, but not identical, provision is made in respect of the Upper Tribunal (TCC) hearing charity cases: Tribunal Procedure (Upper Tribunal) Rules 2008, r 10. Notably, costs orders can be made in judicial review proceedings transferred to the Upper Tribunal (TCC): r 10(3)(a).

<sup>1109</sup> Civil Society, “Commission will consider recovering costs from charities for time wasted on tribunal appeals” (12 October 2015), available at [http://www.civilsociety.co.uk/governance/news/content/20556/commission\\_will\\_consider\\_recovering\\_costs\\_from\\_charities\\_for\\_time\\_wasted\\_on\\_tribunal\\_appeals?utm\\_source=12+October+2015+Governance&utm\\_campaign=12+Oct+2015+Governance&utm\\_medium=email](http://www.civilsociety.co.uk/governance/news/content/20556/commission_will_consider_recovering_costs_from_charities_for_time_wasted_on_tribunal_appeals?utm_source=12+October+2015+Governance&utm_campaign=12+Oct+2015+Governance&utm_medium=email).

<sup>1110</sup> Charities Act 2011, s 115(5). This does not apply to certain exempt charities: sch 9, para 21. There are also limitations on who can pursue such proceedings: s 115(1).

<sup>1111</sup> *Muman v Nagasena* [2000] 1 WLR 299, 305, by Mummery LJ; *Rai v Charity Commission for England and Wales* [2012] EWHC 1111 (Ch), [2012] WTLR 1053 at [26].

<sup>1112</sup> Charities Act 2011, s 115(1).

<sup>1113</sup> When we use the term “charity proceedings” in this chapter, we are referring to the meaning of that term in s 115 of the Charities Act 2011.

with outsiders (which are not).<sup>1114</sup> So a claim by or against a charity for breach of contract would not be charity proceedings, but a dispute concerning the administration of the charity would.<sup>1115</sup>

- 15.7 The Charity Commission may not authorise the taking of charity proceedings where it considers that the case can be dealt with by the Commission under its other powers, unless there are special reasons for doing so.<sup>1116</sup>
- 15.8 If the Commission refuses to authorise proceedings, authorisation can instead be sought from the High Court.<sup>1117</sup>
- 15.9 In the Consultation Paper, we said that “The requirement that the Charity Commission or High Court authorise charity proceedings is long-standing and we have not heard that there is dissatisfaction with it.”<sup>1118</sup> Although two consultees said that uncertainties can arise in some cases, there was no appetite amongst consultees for the requirement to be removed or changed, save in one respect that we had highlighted in the Consultation Paper.
- 15.10 Problems arise if authorisation under section 115 is required from the Charity Commission in respect of a claim that involves the Commission. The Commission would face a conflict of interests in deciding whether to authorise proceedings in which it is a party. The Commission would be required to make an objective decision about whether the proceedings are in the best interests of the charity, but its own interests as a party to those proceedings might demand that authorisation be refused (or granted) regardless of what is in the charity’s interests. Moreover, in deciding whether to give authorisation under section 115, the Charity Commission asks what advice the trustees have received about the merits of their claim.<sup>1119</sup> It would be inappropriate for that advice to be disclosed to the Commission if it is involved in those proceedings as a party.
- 15.11 In the Consultation Paper, we said that court proceedings against the Charity Commission do not fall within the definition of charity proceedings so do not require authorisation from the Commission.<sup>1120</sup> Following consultation, we remain of that view.

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<sup>1114</sup> *Muman v Nagasena* [2000] 1 WLR 299, 305, which concerned the identical wording in the Charities Act 1993.

<sup>1115</sup> *Rendall v Blair* (1890) 45 Ch D 139, decided under the more complicated definition in the Charitable Trusts Act 1853, s 17. Disputes with outsiders would include family provision claims under the Inheritance (Provision for Family and Dependents) Act 1975 or disputes as to whether a trust is charitable, an example of the latter being *Re Belling* [1967] Ch 425. See also *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705.

<sup>1116</sup> Charities Act 2011, s 115(3).

<sup>1117</sup> Charities Act 2011, s 115(5). If the Commission refuses consent and authorisation is sought from the High Court, the court will ask whether there is a legally sustainable claim and, if so, whether the proceedings are the best (or the least worst) course in the interests of the charity as a whole to deal with the dispute: *Rai v Charity Commission for England and Wales* [2012] EWHC 1111 (Ch), [2012] WTLR 1053 at [27].

<sup>1118</sup> Consultation Paper, para 16.18.

<sup>1119</sup> Consultation Paper, p 237, Fig 14.

<sup>1120</sup> Consultation Paper, para 16.19.



- 15.12 But a charity might wish to embark upon charity proceedings in the course of court proceedings against the Charity Commission. This is most likely to be when the charity trustees wish to apply for a *Beddoe* order<sup>1121</sup> in the course of court proceedings against the Charity Commission. As we explain below, a *Beddoe* order provides trustees with assurance that any legal costs they incur can be paid from the trust fund. An application for a *Beddoe* order falls within the definition of charity proceedings. The trustees must therefore seek authorisation to make a *Beddoe* application under section 115 – to protect themselves in substantive proceedings – from the body against which those substantive proceedings will be brought.
- 15.13 A conflict of interest necessarily arises for the reasons set out in paragraph 15.10 above; the Commission’s objective decision as to whether to authorise the *Beddoe* application under section 115 conflicts with the Commission’s interests as (say) defendant to the substantive proceedings to stop those proceedings from progressing. Whilst the conflict could be addressed by the Charity Commission establishing a “Chinese wall” – thereby ensuring that different personnel considered the section 115 application and the substantive claim – the appearance of a conflict would remain.
- 15.14 Our provisional view was that charities should have a choice as to whether they seek authorisation from the Charity Commission or the court in respect of any application within, or in contemplation of, litigation against the Charity Commission, rather than first having to go to the Charity Commission. Nearly all consultees agreed with our proposal. The CLA said that charities should be able to seek authorisation from the court when the Charity Commission is a party to the substantive proceedings, and not just when the substantive proceedings are *against* the Commission. We agree; charities should have the choice to seek authorisation first from the court if making an application (such as for a *Beddoe* order) if the Charity Commission is involved in the substantive proceedings.
- 15.15 So far we have considered applications within court proceedings that involve the Charity Commission, but the potential conflict of interests under section 115 is not limited to such applications. A party to court proceedings involving the Commission might wish to pursue a separate claim that constitutes charity proceedings (such as a claim concerning the construction of the charity’s governing document, or the election of trustees) that is somehow related to the court proceedings involving the Charity Commission.<sup>1122</sup> We think that the ability to seek authorisation from the court rather than first having to go to the Commission should therefore apply to any charity proceedings where the Charity Commission would face an actual or apparent conflict of interests in deciding whether to give authorisation.
- 15.16 We do not think that our recommendation would result in a significant number of applications to the court for permission to bring charity proceedings, in an attempt by charity trustees to by-pass the Charity Commission’s role as gatekeeper to the court (see paragraph 15.7 above). In most cases there will be no conflict so it will (in the first

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<sup>1121</sup> *Re Beddoe* [1893] 1 Ch 547. See *Blackstone’s Civil Practice* (17th ed 2017), paras 44.7 to 44.14; Civil Procedure Rules, r 64.2.3.

<sup>1122</sup> Including a counterclaim or a third party claim within the existing proceedings: see Civil Procedure Rules, Part 20.

instance) fall to the Charity Commission to decide whether to give permission as is currently the case.

15.17 In deciding whether it has jurisdiction to give permission, the court would need to be satisfied of the existence of the conflict, and in deciding whether to give permission, the court would want to know whether the Charity Commission had already refused permission (or indicated its intention to do so) and, if so, its reasons for that decision. If charity trustees attempt to go to court unnecessarily, they may face costs sanctions, namely being prevented from recovering their legal costs from the charity's funds or having to pay any other party's costs of the application.

**Recommendation 40.**

15.18 We recommend that it should be possible to obtain authorisation to pursue "charity proceedings" under section 115 of the Charities Act 2011 from either the court or the Charity Commission in circumstances where the Charity Commission would face an actual or apparent conflict of interests if asked to give such authorisation.

15.19 Clause 38 of the draft Bill would give effect to this recommendation.

Should the Tribunal have the same power?

15.20 Some consultees thought the Tribunal should be able to authorise charity proceedings, especially in situations where they arise within substantive proceedings that fall within the Tribunal's jurisdiction. We can see the logic of this suggestion, but we have concluded that the Charity Tribunal should not be given a power to authorise the pursuit of charity proceedings under section 115. We think it would be rare for a charity to commence charity proceedings within proceedings before the Charity Tribunal (save for applications for a *Beddoe* order, which we address specifically below).<sup>1123</sup> But in any event, we see little difficulty in requiring authorisation under section 115 to be obtained from the court rather than the Tribunal. Any applications or proceedings that amount to "charity proceedings" are, by definition, made to the court,<sup>1124</sup> even if they are made in the context of proceedings in the Tribunal; if the matter is to be heard by the court, we think it should be the court that gives authorisation under section 115. Authorisation can be given without a hearing,<sup>1125</sup> thereby saving costs, and if the Tribunal has expressed the view that the charity proceedings should be pursued, its view can be communicated to and considered by the court when it considers the application for permission under section 115.

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<sup>1123</sup> The CLA thought that "there may be others", but did not give any examples.

<sup>1124</sup> See paras 15.21 to 15.24 below where we explain that applications to the Charity Tribunal cannot fall within the definition of "charity proceedings".

<sup>1125</sup> Civil Procedure Rules, r 64.6(6).

## Tribunal proceedings

Does section 115 apply to Tribunal proceedings?

15.21 In the Consultation Paper, we expressed the view that proceedings in the Charity Tribunal were not “charity proceedings” under section 115.<sup>1126</sup> The definition of charity proceedings, set out in Figure 24 above, refers to proceedings in “any court”. There was an argument during consultation<sup>1127</sup> that proceedings before the Tribunal are charity proceedings on the basis of the definition of “the court” in section 353(1). That definition is:

(a) the High Court; and

(b) within the limits of its jurisdiction, any other court in England and Wales having a jurisdiction in respect of charities concurrent (within any limit of area or amount) with that of the High Court.

15.22 We remain of the view that Tribunal proceedings are not charity proceedings. First, the definition of “the court” in section 353 is not relevant to the interpretation of section 115, which refers to proceedings in “any court”. Second, courts and tribunals are treated separately throughout the Charities Act 2011 and the TCEA 2007. Tribunals are not therefore “any court” under section 115, nor (if our first point is wrong) are tribunals “any other court” within the meaning of section 353(1)(b). The designation of the Upper Tribunal as a “court of record”<sup>1128</sup> means that its decisions set precedent; it does not convert it into a “court” (under section 353 of the Charities Act 2011 or otherwise).

15.23 Third (and, again, if our first point is wrong), the Charity Tribunal does not have a jurisdiction in respect of charities that is “concurrent ... with that of the High Court” (even within any limits of area or amount) under section 353(1)(b). The Tribunal’s jurisdiction is prescribed in Schedule 6 to the Charities Act 2011. That jurisdiction is not concurrent with the court. On an appeal, the Tribunal makes a decision afresh;<sup>1129</sup> by contrast, the court has no jurisdiction to re-make Charity Commission decisions but is limited to judicial review of those decisions. Further, decisions that fall outside Schedule 6 can be subject to judicial review by the court, but the Tribunal has no jurisdiction to hear a challenge. So whilst in some cases the same decision might be challenged by way of judicial review or an appeal to the Tribunal under Schedule 6, the two claims would be different, and the jurisdiction of the Tribunal cannot be said to be concurrent with that of the court.

15.24 Our view is shared by Judge McKenna, Principal Judge of the First-tier Tribunal (Charity).<sup>1130</sup> Were proceedings before the Charity Tribunal to be “charity proceedings”, all appeals and reviews before the Charity Tribunal – which by definition involve a challenge to a decision of the Charity Commission – would require the Commission’s

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<sup>1126</sup> Consultation Paper, para 16.36.

<sup>1127</sup> See the Analysis of Responses, Ch 16, and the response of Hubert Picarda QC on this point.

<sup>1128</sup> By s 3(5) of the TCEA 2007.

<sup>1129</sup> Charities Act 2011, s 319(4).

<sup>1130</sup> A McKenna, “Applications to the First-tier Tribunal (Charity) by “persons affected” by the Charity Commission’s Decision” (2013) 16(9) *Charity Law and Practice Review* 1.

consent. This does not currently occur. As we said in the Consultation Paper, that position is entirely sensible.<sup>1131</sup>

Should there be a permission filter for Tribunal proceedings?

15.25 For the reasons set out above, we do not consider that proceedings before the Tribunal are “charity proceedings” within the meaning of section 115. They do not, therefore, require authorisation from the Charity Commission or the court. In the Consultation Paper we said that the rationale behind section 115 – namely, the protection of charitable funds – was arguably equally relevant to Tribunal proceedings, but our provisional conclusion, on which we invited consultees’ views, was that authorisation should not be required before commencing proceedings in the Tribunal.<sup>1132</sup> The vast majority of consultees shared our view that authorisation should not be required.

15.26 Consultees agreed with us that Tribunal proceedings are different from charity proceedings. Generally, Tribunal proceedings do not concern internal disputes but rather disputes between the charity and the Charity Commission such that if the disputes were before the court instead, they would not require section 115 authorisation. But even if Tribunal proceedings would require section 115 authorisation (if they were instead before the court), consultees thought that a requirement to seek authorisation would increase legal costs for charities and hinder access to the Tribunal, which was intended to be low-cost and user-friendly. Consultees also identified existing safeguards that provide similar protection to section 115; the Tribunal can reject claims of little or no merit<sup>1133</sup> and the costs regime can prevent the misuse of charity funds.<sup>1134</sup>

15.27 We have therefore concluded that charities should not have to obtain authorisation from the Charity Tribunal (or the Charity Commission) before commencing proceedings in the Tribunal.

## **EXPENDITURE ON PROCEEDINGS BEFORE THE COURTS AND THE TRIBUNAL**

15.28 Charities will often incur legal costs when they are involved in litigation before the Charity Tribunal and the courts. We have been informed by Judge McKenna that around 40% of parties to Charity Tribunal proceedings are legally represented. A charitable company or other incorporated charity can incur legal fees in pursuing court proceedings, and can be subject to a costs order if unsuccessful. An unincorporated charity cannot itself incur legal fees or be ordered to pay legal costs. Litigation will instead be conducted by the trustees who will be personally liable for the costs, unless the costs can be paid from the trust fund.

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<sup>1131</sup> Consultation Paper, para 16.37.

<sup>1132</sup> Consultation Paper, paras 16.38 to 16.39. Authorisation would be sought from the Charity Tribunal. We noted the inevitable conflict of interest that an alternative requirement to obtain authorisation from the Charity Commission would involve (since proceedings in the Tribunal involve challenges to Charity Commission decisions), but we said that charities could nevertheless have the option of seeking authorisation from the Charity Commission rather than the Tribunal.

<sup>1133</sup> Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009 SI 2009 No 1976 (as amended), r 8(3)(c).

<sup>1134</sup> See para 15.4 above.

15.29 A trustee can be indemnified from the trust fund for “expenses properly incurred by him when acting on behalf of the trust”.<sup>1135</sup> To ensure that proposed costs would be “properly incurred”, trustees can apply for a *Beddoe* order from the court.<sup>1136</sup> A *Beddoe* order provides trustees with assurance that the costs incurred (or ordered to be paid if the litigation is unsuccessful)<sup>1137</sup> can properly be paid from the trust fund.<sup>1138</sup> The court will make such an order if it decides that the proposed litigation costs would be a proper use of the charity’s funds.

15.30 Applications for *Beddoe* orders fall within the definition of charity proceedings in section 115 of the Charities Act 2011, whether or not the substantive proceedings are also charity proceedings. Accordingly, an application for a *Beddoe* order must be authorised by the Charity Commission or the High Court. The Charity Commission generally refuses authorisation to make an application for a *Beddoe* order because it can deal with the matter using its other powers; the Charity Commission can make an order under section 105 of the Charities Act 2011 authorising the trustees to incur legal costs (and risk an adverse costs order) on behalf of the trust fund, or it can provide an opinion under section 110 to the same effect.<sup>1139</sup>

15.31 Recommendation 40 above will ensure that, when trustees wish to obtain *Beddoe* protection in proceedings that involve the Charity Commission, they will have a choice as to whether to obtain authorisation under section 115 from the court or from the Charity Commission.

### Charity Tribunal proceedings

15.32 The Charity Tribunal is intended to be a user-friendly forum where charities can represent themselves without having to engage lawyers. Given that there is generally no costs-shifting,<sup>1140</sup> it may be that charities would prefer to represent themselves because there is almost no prospect of being able to recover their costs, even if they are successful. The reality, however, is that charities do often instruct lawyers to represent them at the Tribunal. Trustees will want to ensure that any costs incurred in proceedings in the Tribunal will be recoverable from the charity’s funds.

15.33 Currently there is no power for trustees to obtain advance protection, akin to a *Beddoe* order, from the Charity Tribunal in respect of the costs of Tribunal proceedings. Trustees may be discouraged from pursuing action if they are unable to obtain advance

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<sup>1135</sup> Trustee Act 2000, s 31(1). The right also exists at common law: *Re Beddoe* [1893] 1 Ch 547, 558; *Attorney General v Mayor of Norwich* (1837) 2 Myl & Cr 406, 424. See Ch 12 above.

<sup>1136</sup> *Re Beddoe* [1893] 1 Ch 547. See *Blackstone’s Civil Practice* (17th ed 2017) paras 44.7 to 44.14; Civil Procedure Rules, r 64.2.3.

<sup>1137</sup> *McDonald v Horn* [1995] ICR 685, 695, by Hoffman LJ; *Three Professional Trustees v An Infant Prospective Beneficiary* [2007] EWHC 1992 (Ch), [2007] WTLR 1631 at [29].

<sup>1138</sup> There is a dearth of case law concerning *Beddoe* applications made by charity trustees, though some guidance is provided by *Singh v Bhasin* [2000] WTLR 275 and some general principles can be discerned from *Beddoe* applications made in respect of other trusts; see for example *Re Evans* [1986] 1 WLR 101.

<sup>1139</sup> Charity Commission, *Charities and litigation: a guide for trustees* (CC38) (August 2016) para 2.6, available at <https://www.gov.uk/government/publications/charities-and-litigation-a-guide-for-trustees-cc38>. See Consultation Paper, para 16.24 to 16.26.

<sup>1140</sup> See para 15.4 above.

assurance that the expenditure incurred will be recoverable from the charity's funds.<sup>1141</sup> In theory, trustees could seek a *Beddoe* order from the High Court in respect of the costs of proposed proceedings in the Charity Tribunal, and Recommendation 40 above would ensure that authorisation to make such an application (which would be charity proceedings under section 115 of the Charities Act 2011) could be sought from the court rather than the Charity Commission. However, one of the reasons for the creation of the Charity Tribunal was to avoid the need for charities to commence court proceedings; that policy is undermined if *Beddoe* protection in respect of Tribunal proceedings can only be obtained by going to court.

15.34 As an alternative to obtaining a *Beddoe* order from the court, the trustees could ask the Charity Commission for an order or opinion to provide the same level of protection in respect of Tribunal proceedings.<sup>1142</sup> There would be a conflict of interest as the Charity Commission is always a party (and usually the respondent) to proceedings in the Tribunal. The Charity Commission suggested that it could operate a "Chinese wall" to avoid the conflict of interest, but we think that would be unsatisfactory since the appearance of a conflict would remain.<sup>1143</sup>

15.35 In the Consultation Paper we provisionally proposed that the Charity Tribunal should be given the power to make *Beddoe* orders in respect of proceedings before it.<sup>1144</sup> We distinguished between (1) costs that trustees propose incurring in Tribunal proceedings, and (2) costs that trustees might be ordered to pay if they are unsuccessful in the litigation. We said that *Beddoe* protection should be available in respect of both categories of costs. In respect of the second category of costs, we said that there is no real need for the Tribunal to have this power in appeals and reviews, or in references, as there is generally no cost-shifting.<sup>1145</sup> That said, the current rules on costs-shifting are set out in secondary legislation which could be amended by the Tribunal Procedure Committee.<sup>1146</sup> If those rules were to be amended so as to permit costs-shifting then there might be a legitimate call for the Tribunal to be able to provide the second type of *Beddoe* protection. Moreover, costs-shifting is available in judicial review claims that are transferred to the Upper Tribunal (TCC).<sup>1147</sup> We said that a new power for the Charity Tribunal to make *Beddoe* orders should extend to such claims.<sup>1148</sup> In addition,

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<sup>1141</sup> Judge McKenna has suggested that charities may have been discouraged from "using the Tribunal for fear that the Commission would deem the expenditure of charity funds on the case to have been inappropriate..." A McKenna, "Should the Charity Tribunal be reformed?" (2011) 14(1) *Charity Law and Practice Review* 1.

<sup>1142</sup> See para 15.30.

<sup>1143</sup> See paras 15.10 and 15.13 above. Additionally, as the CLA identified, an order or opinion under ss 105 or 110 from the Charity Commission might not be available. For example, if the proceedings in the Tribunal relate to a decision by the Charity Commission not to register an institution as a charity, then that institution will be unable to obtain a s 105 order or s 110 opinion as it is not regarded by the Commission as a charity.

<sup>1144</sup> See Consultation Paper, paras 16.47 to 16.51.

<sup>1145</sup> See para 15.4 above for the meaning of "cost-shifting".

<sup>1146</sup> The costs of and incidental to Tribunal proceedings are in the discretion of the Tribunal, but the exercise of this discretion is subject to the Tribunal Procedure Rules: TCEA 2007, s 29(1) and (3).

<sup>1147</sup> See n 1108 above.

<sup>1148</sup> In theory, an application for a *Beddoe* order could be made to the Administrative Court that transferred the proceedings to the Upper Tribunal, but it would be preferable for a *Beddoe* application to be heard by the Upper Tribunal if the proceedings are currently before it.

costs-shifting is a feature of appeals from the Upper Tribunal to the Court of Appeal. We said that we would expect *Beddoe* orders in respect of the costs of such an appeal to be made by the Court of Appeal,<sup>1149</sup> but we saw no reason to prevent the Tribunal from making such an order, for example at the same time as considering an application for permission to appeal.

15.36 Accordingly, we took the view that *Beddoe* protection should be available in respect of the second category of costs (as well as the first), albeit that we only anticipated it being granted by the Charity Tribunal in judicial review claims that have been transferred from the High Court and possibly in respect of appeals to the Court of Appeal.<sup>1150</sup>

15.37 Most consultees agreed with our proposal. They recognised that without the power some charities may be discouraged from commencing necessary proceedings and raising genuine grievances. Stone King LLP observed that the Tribunal was “well-placed” to weigh up the balance between providing trustees with assurance and safeguarding charities’ funds.

15.38 The Charity Commission disagreed with the proposal for three reasons, which we summarise and respond to below.

- (1) First, the Commission said that it would add cost and delay to Tribunal proceedings.

Applications for *Beddoe* protection would not be made in all cases, and when they are made they will usually be considered without a hearing. The Charity Commission would not be involved in the process; it would be a matter between the trustees and the Tribunal. Accordingly, if the trustees choose to apply for *Beddoe* protection, there might be a slight increase in the charity’s (but not the Commission’s) costs and, in some cases, there might be a short delay to the timetable for the proceedings. In our view, however, that potential delay and increase in the charity’s costs is justified by the valuable protection that an order will provide for trustees, and it will certainly be less time-consuming and cheaper than having to go to court to obtain equivalent protection from a *Beddoe* order.

- (2) Second, the Commission suggested that there are adequate powers in place to address trustees’ concerns about costs, namely the Tribunal’s case management powers<sup>1151</sup> and the availability of advance assurance from the Charity Commission.<sup>1152</sup>

We do not think that these powers provide sufficient protection. The Tribunal’s case management powers might filter out particularly unmeritorious claims, but

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<sup>1149</sup> In addition, Civil Procedure Rules, r 52.9A which came into force on 1 April 2013, allows the Court of Appeal to limit the recoverable costs on an appeal from the Upper Tribunal: see *Blackstone’s Civil Practice* (17th ed 2017) para 75.22.

<sup>1150</sup> Consultation Paper, para 16.51.

<sup>1151</sup> See para 15.26 above.

<sup>1152</sup> The Charity Commission can make an order under s 105 authorising the trustees to incur legal costs (and risk an adverse costs order) on behalf of the trust fund, or it can provide an opinion under s 110 to the same effect: see para 15.30 above.

those powers might not be exercised for a variety of reasons. Moreover, trustees are not safe to assume that, just because the Tribunal has not filtered out the case, that the proceedings are an appropriate use of funds. Nor do we think that the Commission's existing powers to give advance assurance are sufficient owing to the conflict of interest that arises.<sup>1153</sup>

- (3) Third, the Charity Commission said that costs orders are not usually made, so there is no need for *Beddoe* protection.

That reasoning only applies to costs ordered to be paid to another party in the proceedings; it provides no assurance to trustees that the costs that they incur can properly be paid from the charity's funds.

15.39 In the light of consultation, we remain of the view that the Tribunal should be given a power to provide charity trustees with *Beddoe* protection. Francesca Quint suggested that the power should be given a new concept and name rather than be known as a *Beddoe* order. We agree. The power of the High Court to make *Beddoe* orders stems from its jurisdiction over trusts. The power that we recommend would be conferred by statute, and would benefit from a name that describes its function rather than by reference to the case that created the equivalent power in the High Court. We therefore recommend the creation of a statutory power for the Tribunal to make "authorised costs orders" which would provide protection that is equivalent to a *Beddoe* order from the High Court.

The procedure for applying for an authorised costs order

15.40 Applications to the Charity Tribunal for an authorised costs order under a new statutory power would not be charity proceedings under section 115 of the Charities Act 2011<sup>1154</sup> and would not therefore require the consent of the Charity Commission or court.

15.41 The Tribunal Procedure Committee could make procedure rules governing applications for authorised costs orders, including directions as to the documentation that trustees should file in support of such an application.<sup>1155</sup> *Beddoe* applications to the court are generally considered without a hearing,<sup>1156</sup> and we would expect the position to be the same in respect of applications for an authorised costs order to the Tribunal. We expect that the application could be considered by a single judge, rather than a full tribunal panel.

15.42 An application for an authorised costs order would require disclosure to, and consideration by, the Tribunal of the strengths and weaknesses of the substantive claim. It would therefore be appropriate for the substantive claim to be heard by different

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<sup>1153</sup> See para 15.34 above.

<sup>1154</sup> See paras 15.21 to 15.24 above.

<sup>1155</sup> Similarly to Civil Procedure Rules 1998, Practice Direction 64B, para 7.2.

<sup>1156</sup> Civil Procedure Rules 1998, Practice Direction 64A, para 6.5 and Practice Direction 64B, para 6.1.



members of the Tribunal than those who previously decided the application for an authorised costs order.<sup>1157</sup>

Considering an application for an authorised costs order

15.43 In considering an application for an authorised costs order, the Tribunal should apply the same criteria as the court would apply in respect of an application for a *Beddoe* order in court proceedings. The Tribunal will have to consider the trustees' prospects of success and whether the litigation is in the charity's interests.

Involvement of the Attorney General

15.44 The Attorney General is always a party to charity proceedings in court as the constitutional protector of charity.<sup>1158</sup> Proceedings before the Tribunal are not charity proceedings under section 115 of the Charities Act 2011<sup>1159</sup> and therefore an application for an authorised costs order would not necessitate the Attorney General's involvement. It would be possible to require applications to name the Attorney General as a party, to ensure that the Tribunal hears competing arguments as to the appropriateness of an authorised costs order. We do not, however, think that this is necessary, since the Tribunal can be trusted to exercise the power carefully. If the Tribunal has doubts about whether an authorised costs order would be appropriate, it can refuse the application or invite the Attorney General to become a party for the purposes of considering the application.<sup>1160</sup>

15.45 Almost all consultees agreed with us that the Attorney General should not always be a party to applications for an authorised costs order, but instead be invited to participate in appropriate cases. The Attorney General's Office recognised that the Tribunal was "competent to assess whether litigation is an appropriate use of charity funds".

Creating the new power

15.46 It has been suggested that the Charity Tribunal could be given a power to make authorised costs orders by secondary legislation under section 29 of the TCEA 2007.<sup>1161</sup> In the Consultation Paper we suggested that the scope of section 29 was insufficient to allow such a power to be created.<sup>1162</sup> The CLA agreed with us.<sup>1163</sup> We remain of the

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<sup>1157</sup> It might be possible for the First-tier Tribunal that has heard and decided a substantive claim to make an authorised costs order in respect of the costs of an appeal against that decision to the Upper Tribunal, after the First-tier Tribunal has given permission to appeal.

<sup>1158</sup> Civil Procedure Rules 1998, Practice Direction 64A, para 7; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 924 and following.

<sup>1159</sup> See paras 15.21 to 15.24 above.

<sup>1160</sup> Under Charities Act 2011, s 318, and Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009 SI 2009 No 1976 (as amended), r 31.

<sup>1161</sup> Costs in Tribunals, Report by the Costs Review Group to the Senior President of Tribunals (December 2011), available at <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/costs-review-group-report-tribunals-dec-2011.pdf>.

<sup>1162</sup> Consultation Paper, paras 16.56 to 16.59.

<sup>1163</sup> The Ministry of Justice Jurisdiction and Procedure Branch said that the Tribunals Procedure Committee is currently considering whether to introduce the power, but have not concluded this matter.

view expressed in the Consultation Paper that a power for the Charity Tribunal to make authorised costs orders requires primary legislation.

**Recommendation 41.**

15.47 We recommend that the Charity Tribunal be given the power to make “authorised costs orders” in respect of proposed or ongoing Tribunal proceedings that would provide charity trustees with advance assurance that:

- (1) costs already incurred or proposed to be incurred; and
- (2) costs ordered to be paid if the litigation is unsuccessful;

can properly be paid from the charity’s funds.

15.48 Clause 39 of the draft Bill would give effect to this recommendation.

**SUSPENDING THE EFFECTS OF A CHARITY COMMISSION SCHEME OR DECISION PENDING THE DETERMINATION OF A CASE**

15.49 In the Consultation Paper, we said that the utility of challenges by third parties,<sup>1164</sup> charities, or individual trustees to the Charity Tribunal are potentially undermined if the Charity Tribunal has no power to suspend a Charity Commission decision pending the outcome of the challenge. If, for example, the Commission makes a scheme on which the charity relies, any successful challenge to that scheme might amount to a Pyrrhic victory if the charity has already taken action in reliance on the scheme (for example, by selling land).<sup>1165</sup> We said that, in principle, it would be helpful for the Tribunal to have a power to suspend the effect of a Charity Commission decision pending resolution of a challenge, but we identified various practical problems that would arise which led us to the provisional view that no such power should be introduced.<sup>1166</sup>

15.50 Many consultees expressed support for a power to suspend the effect of Charity Commission decisions pending a challenge or a power to award interim injunctions. They generally did not, however, identify solutions to the various problems that we had identified.

15.51 We identified two problems that arise when a Charity Commission decision is challenged, whether in the Tribunal or the courts.

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<sup>1164</sup> Sch 6 to the Charities Act 2011 often permits appeals and reviews (see Fig 23 above) to be brought by “persons affected” by the Charity Commission’s decision. Such challenges can, effectively, be challenges by third parties against the decision of a charity, where the charity’s decision has been given effect by a Charity Commission scheme or order. See, generally, A McKenna, “Applications to the First-tier Tribunal (Charity) by “persons affected” by the Charity Commission’s decision” (2014) 16 *Charity Law and Practice Review*, pp 147 to 162.

<sup>1165</sup> See our discussion of *Aliss and Hesketh v The Charity Commission for England and Wales* (31 August 2012) FTT (GRC) (Charity) in the Consultation Paper, para 16.65 to 16.77.

<sup>1166</sup> Consultation Paper, paras 16.77 to 16.85.

- (1) The complainant will want to prevent the charity or the Charity Commission from taking any action in reliance on the decision, pending the outcome of the challenge to that decision (“the first problem”).
- (2) Even if such action can be prevented, the horse might already have bolted; swift-footed charities could still take action in reliance on a decision before a complainant can prevent it (“the second problem”).

15.52 The first problem could be addressed by conferring powers on the Tribunal to suspend a Charity Commission decision or award an interim injunction restraining the proposed action pending the outcome of the challenge. However, for the following reasons, we do not think that this would be practical:

- (1) The power to award an interim injunction is best reserved for the court. Conferring such a power on the Tribunal would be out of keeping with the Tribunal's general powers. The Ministry of Justice Jurisdiction and Procedure Branch suggested that it would require an examination of “the implications of a change in relation to tribunals performing this role”. Moreover, if the Tribunal could award an interim injunction then it would be necessary to create a mechanism within the Charity Tribunal for such injunctions to be enforced.<sup>1167</sup>
- (2) Charities can already seek an interim injunction from the court to prevent a charity or the Charity Commission from taking action in reliance on a decision, pending a challenge.
- (3) Suspending a decision would render any action taken in reliance on it void. That could have serious consequences for third parties transacting with charities. The problem could be lessened by the creation of a public register of decisions that are currently in suspense, but that would involve a call on the public purse and might make third parties reluctant to transact with charities at all. And expecting third parties to check such a register before transacting with charities seems excessive.<sup>1168</sup>
- (4) The Charity Commission would be hindered from performing its functions effectively if certain regulatory decisions could be suspended, such as the Commission's power to open an inquiry. Consultees emphasised that some decisions require immediate action such as appointing interim managers and “freezing” bank accounts, and these powers would be redundant if they could be suspended pending a challenge.<sup>1169</sup>

15.53 Our view is that the practical problems that arise in addressing the first problem outweigh the advantages of resolving it. Even if the Tribunal were able to suspend decisions or award an interim injunction there is the possibility that the charity might already have acted upon the decision, which raises the second problem (see paragraph 15.51(2) above). The only solution to the second problem would be for statute to provide

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<sup>1167</sup> Alternatively, the matter could be transferred to the court for enforcement, but it would be less complicated for the court to award the injunction initially (as it can already do).

<sup>1168</sup> Stewardship said that a register would create undue burdens for third parties.

<sup>1169</sup> Charity Commission; and Veale Wasbrough Vizards LLP.

that no challengeable decision of the Charity Commission is to be of any effect for a certain period of time after it is made to allow time for a challenge to be made.<sup>1170</sup>

15.54 Most consultees agreed with our provisional view that automatically delaying the coming into effect of all Charity Commission decisions would be an unwelcome and controversial solution with wide-ranging consequences.

- (1) Transactions that depend on Charity Commission decisions to proceed would be delayed and this could damage charities when transactions are time-critical.
- (2) The Charity Commission was concerned that automatically delaying its decisions would render some of its decisions redundant, for example, the Commission's power to open an inquiry or to appoint an interim manager.<sup>1171</sup> Delaying the effect of decisions would permit individuals to continue to engage in misconduct or to take pre-emptive steps in the knowledge that the Charity Commission intends to intervene.
- (3) Most Charity Commission decisions are uncontroversial and ought to take immediate effect; suspending all Charity Commission decisions would seem to be a disproportionate response to a relatively infrequent problem.
- (4) Moreover, providing potential complainants with a window within which to make a challenge before a decision takes effect would be of limited assistance if they do not become aware of the decision within that period. Unless the Charity Commission is required to publish every decision it makes – which would be a substantial and expensive undertaking – automatic temporary suspension of decisions might be of no assistance to complainants.

15.55 Two consultees suggested that particularly controversial decisions should be suspended to allow time for an appeal.<sup>1172</sup> We think that the suspension of controversial decisions could be addressed by way of Charity Commission practice rather than law reform.<sup>1173</sup> There are existing publicity requirements when the Charity Commission intends to make schemes or remove trustees. Moreover, as the CLA said, the Charity Commission will usually know if a decision to make a scheme is likely to be controversial because there will have been consultation with stakeholders about the trustees' proposals. The Commission ought also to be able to judge whether other decisions are likely to be controversial.

15.56 In cases which are likely to be controversial and where there is no pressing time sensitivity, we think that the Commission should make a decision which is to take effect

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<sup>1170</sup> This could be subject to a power for the Charity Tribunal or court to abridge time and allow the decision to take effect immediately.

<sup>1171</sup> See also para 15.52(4) above.

<sup>1172</sup> Stone King LLP suggested that decisions with a "significant potentially irreversible impact" should be suspended. Similarly, Francesca Quint identified a "halfway-house" where the Charity Commission or Tribunal could suspend particularly controversial decisions until the period for bringing an appeal had expired.

<sup>1173</sup> Prof Gareth Morgan suggested an approach that relied on Charity Commission practice rather than law reform; he said that the Commission should try to make decisions which "as far as possible only take place after (say) 14 days except in cases where there is a real likelihood of abuse in the meantime".

on a future date. The Commission could specify, for example, that its decision takes effect on the later of (a) 42 days after the date of the decision,<sup>1174</sup> or (b) the conclusion of any proceedings which involve a challenge to the decision. This practice would go some way to ensure that complainants can make meaningful challenges to the Tribunal and to the court in respect of Charity Commission decisions.

15.57 We have therefore concluded that the Tribunal should not have the power to suspend the effect of a Charity Commission decision pending challenge or to award an interim injunction. Nor should all decisions of the Charity Commission take effect only after a certain time. Rather than being addressed by law reform we think that steps could be taken by the Charity Commission to ensure that controversial decisions are not acted upon until potential complainants have had an opportunity to make a challenge.

#### **Recommendation 42.**

15.58 We recommend that the Charity Commission delay the date on which its decisions take effect to allow time for a challenge (to the Tribunal or to the court) where the decision is likely to be controversial and is not time-sensitive.

## **REFERENCES TO THE CHARITY TRIBUNAL**

### **Procedure for references by the Charity Commission to the Charity Tribunal**

15.59 The Charity Tribunal has jurisdiction to hear references on questions of charity law from the Attorney General and from the Charity Commission. The Attorney General can make references of his or her own volition, but references by the Charity Commission can only be made with the consent of the Attorney General. Lord Hodgson noted respondents' views that this requirement "[presented] a barrier to the Commission's ability to contribute constructively to the development of the law against which it is required to regulate. It is also true to say that the Commission has a great deal more daily interaction with charity law than the Attorney General's Office, and so is likely to become more quickly seized of issues". He concluded that the Charity Commission should have the power to make references without the Attorney General's consent, provided notification is given to the Attorney and that the Attorney retains the power to be joined as a party to the proceedings.<sup>1175</sup>

15.60 During the passage of the Charities Act 2006 through Parliament, it was said that the purpose of the requirement for the Attorney General's consent was to ensure that the Charity Commission and Attorney General do not duplicate work.<sup>1176</sup> We said that this purpose could be achieved equally by a requirement that the Charity Commission and Attorney General notify each other in advance of making a reference to the Tribunal.<sup>1177</sup>

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<sup>1174</sup> The time limit for issuing a challenge against a Charity Commission decision to the Tribunal is 42 days: Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009 SI 2009 No 1976 (as amended), r 26.

<sup>1175</sup> Hodgson Report, para 7.30 and p 86, recommendation 8.

<sup>1176</sup> Hansard (HL), 12 October 2005, vol 674, col 345.

<sup>1177</sup> Consultation Paper, para 16.89.

We suggested some other reasons for the requirement in the Consultation Paper<sup>1178</sup> and asked consultees whether the requirement for the Attorney General's consent should be removed.

15.61 The majority of consultees thought that the Attorney General's consent should not be required, but instead that the Charity Commission should notify the Attorney General before making a reference. The Charity Commission is generally "well-placed"<sup>1179</sup> to make references with "nearly all the 'hands-on' experience of charities".<sup>1180</sup> The Attorney General agreed that the consent requirement should be removed; it "would enable the Charity Commission to contribute constructively towards the development of charity law...without the need for the duplication of functions in requesting the consent of the Attorney General".

15.62 The consultees who disagreed with removing the requirement thought that consent was needed to provide a degree of oversight over the references. However, we think that the Charity Commission has the expertise and experience to decide whether a reference would be helpful and that it should therefore be able to make a reference without this restriction. The Attorney General will remain aware of references through a notification requirement. In practice, the Charity Commission and the Attorney General's Office would work together and discuss the proposed questions in advance of making a reference.

15.63 Judge McKenna, Principal Judge of the First-tier Tribunal (Charity), has raised with us a concern about removing the requirement for the Attorney General to consent to references by the Charity Commission. The Charity Commission can make a reference to the Tribunal about "the application of charity law to a particular state of affairs", and any charity "which is likely to be affected by the Tribunal's decision" can be a party to the reference.<sup>1181</sup> Once the reference is determined, the Charity Commission must give effect to the decision "when dealing with the particular state of affairs to which the reference related".<sup>1182</sup> Section 330(1) provides that any charity that was a party to the reference, and to whom the Charity Commission has issued an order or direction in reliance on the Tribunal's decision, is precluded from making an appeal to the Tribunal in respect of that order or direction. Judge McKenna suggested that:

If a charity will be bound by the Tribunal's decision on a Reference (determining a hypothetical situation) then I am concerned that it would be unfair to prevent it subsequently litigating about a real situation which affects it. ... In these circumstances, where the prospective Respondent [i.e. the Charity Commission] to proceedings would be in a position to use a Reference to the Tribunal effectively to "block" future litigation against it, I regard the need for the consent of the [Attorney General] as a vital constitutional safeguard.

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<sup>1178</sup> Consultation Paper, para 16.91.

<sup>1179</sup> Attorney General's Office.

<sup>1180</sup> Francesca Quint.

<sup>1181</sup> Charities Act 2011, s 325.

<sup>1182</sup> Charities Act 2011, s 327(3).

15.64 Judge McKenna contrasted section 330 with the procedure rules governing “lead cases”.<sup>1183</sup> Those rules give appellants an opportunity to make representations as to why they should not be bound by the decision in a lead case, which Judge McKenna thought was a fairer procedure.

15.65 We would make five arguments in response.

- (1) First, the Attorney General would still be given notice of a reference and is entitled to be a party to the proceedings, so any concerns about charities being bound by the Tribunal’s decision can be raised with the Tribunal. We do not therefore think that removing the Attorney General’s veto creates a problem.
- (2) Second, even if there is a problem, it is a problem with section 330 (which falls outside the scope of our project). If the requirement for the consent of the Attorney General provides a safeguard, it is a collateral benefit rather than the purpose for which the consent requirement has been imposed.
- (3) Third, under the current law, we do not think that the Attorney General would have section 330 in mind when deciding whether to consent to a reference to the Tribunal. Rather, the Attorney General’s decision would be based on more immediate factors, principally whether the Charity Commission was asking the right questions in the reference and whether it would be helpful for those questions to be resolved.
- (4) Fourth, a charity falling within section 330 has had the opportunity to be heard, and present its case to the Tribunal, on the very issue in respect of which the Commission then issues an order or direction. It also has an opportunity to appeal against the Tribunal’s decision on the reference. We do not therefore think that the charity is denied access to justice when the order or direction is actually issued.
- (5) Fifth, in respect of the comparison with lead cases we think that section 330 may provide appellants with greater protection than the procedure rules for lead cases since charities have a choice whether to be a party to a reference.<sup>1184</sup> In making that choice the charity can bear in mind the consequences under section 330 of being party. By contrast, the procedure rules for lead cases do not give appellants a choice as to whether or not they should be bound by the decision, but rather an opportunity to ask the Tribunal to rule that they should not be bound by the decision.

15.66 In summary, therefore, if there is a problem with section 330, the current requirement for the Attorney General to consent to references is not a solution to it, and removing that requirement is not going to make the problem any worse. The only solution to the problem (if there is one) is to consider reforming section 330, which is not within the scope of our project and is not an issue on which we consulted.

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<sup>1183</sup> Tribunal Procedure Rules (General Regulatory Chamber), r 18(4).

<sup>1184</sup> Charities Act 2011, s 325(4).

### **Recommendation 43.**

15.67 We recommend that the Charity Commission should not be required to obtain the Attorney General's consent before making a reference to the Charity Tribunal, but that the Charity Commission and the Attorney General should be required to give the other four weeks' advance notice of any intended reference.

15.68 Clause 40 of the draft Bill would give effect to this recommendation.

### **The powers exercisable by the Charity Tribunal when considering references**

15.69 As noted in Figure 23 above, the Charities Act 2011 provides that "questions" may be referred to the Charity Tribunal which involve either the operation of charity law in any respect or its application to a particular state of affairs.<sup>1185</sup> The Act does not confer powers on the Tribunal to award particular remedies on determining a reference, such as an order quashing a decision of the Charity Commission or an award of damages. Rather, the Act refers to "determining" or "deciding" references.<sup>1186</sup> In the Consultation Paper we discussed whether the Tribunal should be permitted to award remedies.<sup>1187</sup> We concluded that the Charity Tribunal has adequate powers to deal with references and should not be able to award particular remedies in references.

15.70 Generally consultees agreed with our provisional view that the Charity Tribunal should not have the power to award remedies in reference proceedings. The CLA said that "the question of what remedies, if any, the Tribunal should have available to it in reference proceedings depends upon the intended purpose and effect of such proceedings". We agree. The purpose of the reference procedure is to permit the Charity Commission or the Attorney General to seek clarification on questions of charity law from the Tribunal. It was introduced to avoid the need for charities to incur the costs of commencing proceedings to resolve points of general uncertainty in the law.<sup>1188</sup> Judge McKenna has referred to references as "a novel procedure, designed to settle questions of general importance to the charity sector without the need for individual charities to appeal against a specific decision".<sup>1189</sup>

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<sup>1185</sup> Charities Act 2011, s 325(1) and 326(1). References by the Charity Commission must also have "arisen in connection with the exercise by the Commission of any of its functions": s 325(1)(a).

<sup>1186</sup> Charities Act 2011, ss 315(2), 325(4)(b)(i), 326(3)(b)(i) and 327(3)(b).

<sup>1187</sup> See paras 16.96 to 16.99 of the Consultation Paper where we discussed *R (Independent Schools Council) v The Charity Commission for England and Wales* [2010] EWHC 2604 (Admin); *Independent Schools Council v Charity Commission for England and Wales* [2011] UKUT 421 (TCC).

<sup>1188</sup> The Draft Charities Bill, Report by the Joint Committee on the Draft Charities Bill (2003-2004) HL Paper 167-1, HC 660-1, para 241 available at <http://www.publications.parliament.uk/pa/jt200304/jtselect/jtchar/167/167.pdf>; Government Reply to the Report from the Joint Committee on the Draft Charities Bill (2004) Cm 6440, para 27, available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/251106/6440.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251106/6440.pdf).

<sup>1189</sup> A McKenna, "The Charity Tribunal – where to and from" (2014) 4 *Private Client Business* 213. See also D Morris, "The First-tier Tribunal (Charity): enhanced access to justice for charities or a case of David versus Goliath?" (2010) 29(4) *Civil Justice Quarterly* 491.



15.71 As we said in the Consultation Paper, “remedies should become available if the Charity Commission acts in such a way that is inconsistent with the Tribunal’s decision in a reference; before that point, it would be premature for the Charity Tribunal to award remedies.”<sup>1190</sup> We agree with those consultees who said that remedies are unnecessary since the purpose of the reference procedure is to clarify the law and not to provide remedies for individual disputes.

The status of Tribunal decisions following a reference

15.72 There was some uncertainty from some consultees regarding the outcome of references, specifically who is bound by the decisions. In principle, the Tribunal authoritatively sets out the law in its decision, and it is then for charities, the Charity Commission and practitioners to apply the law to the facts of individual cases. A decision of the Upper Tribunal provides binding precedent.<sup>1191</sup> In addition, as noted above, the parties to reference proceedings cannot appeal to the Tribunal against a decision of the Charity Commission that gives effect to the Tribunal’s decision.<sup>1192</sup> It is, of course, open to charities that were not involved with the reference and who disagree with it, to argue that the decision is wrong or that it applies to the charity in a particular way.

15.73 The CLA said, “considering the question of references is difficult at present, when only two have been brought in several years since the jurisdiction was introduced”. We agree; we are not currently persuaded that there is a problem concerning the status of Tribunal decisions following a reference that can or should be solved by law reform.

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<sup>1190</sup> Consultation Paper, para 16.98.

<sup>1191</sup> TCEA 2007, s 3(5), designating the Upper Tribunal a court of record.

<sup>1192</sup> Charities Act 2011, s 330. See para 15.63 above.

## Chapter 16: Recommendations

### Recommendation 1.

16.1 We recommend that Government periodically review all financial thresholds in the Charities Act 2011 with a view to increasing them, by secondary legislation, in line with inflation.

**[Paragraph 3.17]**

### Recommendation 2.

16.2 We recommend that:

- (1) an amendment to a CIO's constitution by resolution of its members should take effect on the date the resolution is passed, or on a later date specified in the resolution; save that
  - (a) an amendment that makes a regulated alteration should be ineffective unless the prior consent of the Charity Commission has been obtained; and
  - (b) a change of a CIO's purposes should not take effect until it has been registered by the Charity Commission;
- (2) the description of changes to a charity's objects as a "regulated alteration" in section 198(2)(a) be amended to reflect the description in section 226(2)(a); and
- (3) the Charities Act 2011 be amended to provide that the court and Charity Commission's power to make schemes in respect of charities extends to corporate charities.

**[Paragraph 4.23]**

### Recommendation 3.

16.3 We recommend that:

- (1) in place of section 280 of the Charities Act 2011, unincorporated charities be given a new statutory power to amend any provision in their governing documents, subject to a requirement that the Charity Commission approves the following amendments:
  - (a) amendments that would be "regulated alterations" under section 198 if they were made by a company (as amended in accordance with Recommendation 2 above);
  - (b) any amendment to a restriction that renders property permanent endowment;

- (c) any amendment that – had it been made under an express power of amendment – would have required the consent of a person (other than a trustee or member), unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence;
  - (d) any amendment that would affect any right directly conferred by the governing document on (i) a named person, or (ii) the holder of an office or position specified in the governing document (other than that of a trustee or member), unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence; and
  - (e) any amendment which would confer power on the charity trustees to make an amendment falling within paragraphs (a) to (d) above;
- (2) in the case of a charitable trust, the power should be exercisable by a resolution of 75% of the trustees;
- (3) in the case of a charitable unincorporated association that has a body of members with an entitlement under the governing document, to attend and vote at a general meeting, the power should be exercisable:
- (a) by a resolution of a majority of the trustees; and
  - (b) by a further resolution of those members which is passed:
    - (i) at a general meeting, by 75% of those members who attend and vote on the resolution;
    - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the general meeting; or
    - (iii) otherwise than at a general meeting, unanimously;
- (4) in the case of amendments that require the consent of the Charity Commission, the trustees should be able to seek that consent before putting the resolution to a vote of the charity's members;
- (5) amendments should take effect on the later of:
- (a) the date of the resolution;
  - (b) the date specified in the resolution for it to take effect (if any);
  - (c) the date on which the resolution of the members of the charity is passed (if such a resolution is required); or
  - (d) the date on which the Charity Commission consents to the amendment (if such consent is required);
- (6) the power should only be exercised where the charity trustees are satisfied that it is expedient in the interests of the charity to pass the resolution;

- (7) the power should not be exercised in any way which would result in the institution ceasing to be a charity;
- (8) the Charity Commission should be given a power to give public notice, or require the charity trustees to give public notice, of any amendment in respect of which the Commission's consent is required; and
- (9) section 275 of the Charities Act 2011 should be repealed.

**[Paragraph 4.121]**

#### **Recommendation 4.**

16.4 We recommend that:

- (1) when considering whether to consent to:
  - (a) a company or CIO changing its purposes under sections 198 and 226 of the Charities Act 2011; and
  - (b) an unincorporated charity changing its purposes under the new amendment power that we recommend above;

the Charity Commission should be required to have regard to the following matters:

  - (c) the purposes of the charity when it was established;
  - (d) the desirability of securing that the property is applied for charitable purposes which are close to the purposes being altered; and
  - (e) the need for the relevant charity to have purposes which are suitable and effective in the light of current social and economic circumstances; and
- (2) the Charity Commission should be given a power to give public notice, or require the charity trustees to give public notice, of any amendment by a charitable company or CIO in respect of which the Commission's consent is required.

**[Paragraph 4.139]**

#### **Recommendation 5.**

16.5 We recommend that:

- (1) a statutory power be created for Royal Charter charities to amend any provision in their Royal Charter which cannot be amended under any existing express power of amendment, subject to the amendment being approved by the Privy Council;
- (2) in the case of a charity that has a body of members with an entitlement to vote under the Royal Charter, the power should be exercisable:
  - (a) by a resolution of a majority of the trustees; and

- (b) by a further resolution of those members which is passed:
  - (i) at a general meeting, by 75% of those members who attend and vote on the resolution;
  - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the meeting; or
  - (iii) otherwise than at a general meeting, unanimously;
- (3) in the case of a charity without a separate body of members, the power should be exercisable by a resolution of 75% of the trustees;
- (4) the trustees should be able to seek an indication from the Privy Council as to whether a proposed amendment would be approved before putting the resolution to a vote of the charity's members; and
- (5) amendments should take effect on the date on which the Privy Council consents to the amendment (or, if the resolution specifies a later date for it to take effect, on that date).

**[Paragraph 5.56]**

#### **Recommendation 6.**

16.6 We recommend that:

- (1) the Privy Council review its current policy of requiring all petitions by charities for Charters and for supplemental Charters to be publicised in the London Gazette for eight weeks with a view to removing, or replacing, that requirement; and
- (2) the Privy Council cease to require Charters or supplemental Charters granted to charities to be printed on vellum.

**[Paragraph 5.69]**

#### **Recommendation 7.**

16.7 We recommend that:

- (1) in order to improve the process by which charities can make constitutional amendments:
  - (a) the Privy Council Office, in consultation with the Charity Commission and DCMS, produce guidance concerning the process by which Royal Charter charities can amend their governing documents;
  - (b) the Charity Commission and DCMS produce guidance concerning the process by which statutory charities can amend their governing documents;

- (2) in order to facilitate the re-allocation of provisions within governing documents:
  - (a) the Privy Council Office, in consultation with the Charity Commission and DCMS, produce guidance for Royal Charter charities concerning the types of provisions that should generally appear in the Royal Charter, the bye-laws or the regulations;
  - (b) the Charity Commission, in consultation with DCMS, produce guidance for different statutory charities concerning the types of provision that should generally be subject to Parliamentary control; and
- (3) the PCO amend its guidance to make clear that amendments to bye-laws only require approval when that is expressly required by the Royal Charter itself.

**[Paragraph 5.107]**

#### **Recommendation 8.**

16.8 We recommend that the Privy Council Office establish a user group to allow those who engage with the process of amending Charters and bye-laws to propose and discuss improvements to the procedures.

**[Paragraph 5.114]**

#### **Recommendation 9.**

16.9 We recommend that all section 73 schemes be subject to the negative procedure, regardless of whether the governing document is contained in a private Act or a public general Act.

**[Paragraph 5.118]**

#### **Recommendation 10.**

16.10 We recommend that, in order to facilitate the amendment of, and the re-allocation of provisions within, the governing documents of Welsh higher education institutions (“HEIs”), the Welsh Government should consider introducing the following measures:

- (1) the publication of guidance concerning the process for amending governing documents;
- (2) following consultation with the sector, the publication of guidance (either by the Welsh Government or some other public body) setting out the matters of public interest in the governing documents of HEIs, amendment of which should remain subject to oversight; and
- (3) the removal of the requirements in the Education Reform Act 1988 as to the content of the governing documents of higher education corporations so as to enable those bodies to re-allocate provisions in accordance with guidance concerning public interest matters.

**[Paragraph 5.152]**

### **Recommendation 11.**

16.11 We recommend that:

- (1) in the case of failed appeals, a donation should be applicable cy-près without the trustees having to take steps to contact the donors in order to offer to return the donation if:
  - (a) the donation does not exceed £120; and
  - (b) the trustees reasonably believe that the total given by the donor to the fundraising appeal over the financial year did not exceed £120;unless the donor states that the donation must be returned if the specific charitable purposes fail.
- (2) those financial thresholds should be capable of amendment by way of secondary legislation.

**[Paragraph 6.46]**

### **Recommendation 12.**

16.12 We recommend that sections 63 to 66 of the Charities Act 2011, concerning the cy-près application of the proceeds of failed appeals, be simplified as follows.

- (1) Case (1) (the advertisement and inquiry requirements under section 63 of the Charities Act 2011) should be replaced with a requirement that the trustees take reasonable steps to contact donors in order to offer the return of their donations, such steps to be agreed in advance with the Charity Commission.
- (2) After proceeds of a failed appeal have been applied cy-près pursuant to Case (1), the six-month period in which donors can continue to make a claim for the return of their donations should be removed.
- (3) Case (2) (the disclaimer procedure in section 63(1)(b)) and Case (3) (the declaration procedure in section 65) should be repealed.

**[Paragraph 6.65]**

### **Recommendation 13.**

16.13 We recommend that, where the proceeds from failed appeals and from surplus cases are applicable cy-près:

- (1) trustees should have a power to resolve that the proceeds be applied for new purposes, having regard to:
  - (a) the desirability of securing that the purposes are, so far as reasonably practicable, similar to the specific charitable purposes for which the proceeds were given; and
  - (b) the need for the purposes to be suitable and effective in the light of current social and economic circumstances;

- (2) if the proceeds exceed £1,000, such a resolution should only take effect when the Charity Commission consents to it; and
- (3) that financial threshold should be capable of amendment by way of secondary legislation.

**[Paragraph 6.80]**

#### **Recommendation 14.**

16.14 We recommend that:

- (1) the category of designated advisers under Part 7 of the Charities Act 2011 be expanded to include fellows of the National Association of Estate Agents and fellows of the Central Association of Agricultural Valuers;
- (2) qualified charity trustees, officers and employees be able to give advice under sections 119(1)(a), 120(2)(a) and 124(2) of the Charities Act 2011; and
- (3) the Charities (Qualified Surveyors' Reports) Regulations 1992 be replaced with regulations that require designated advisers to provide:
  - (a) advice concerning:
    - (i) what sum to expect (or, if an offer has already been made, whether the offer represents the market value of the land);
    - (ii) whether (and, if so, how) the value of the land could be enhanced;
    - (iii) marketing the land (or, if an offer has already been made, any further marketing that would be desirable);
    - (iv) anything else which could be done to ensure that the terms of the transaction are the best that can reasonably be obtained for the charity; and
  - (b) a self-certification by the adviser that they:
    - (i) have the appropriate expertise and experience to provide the advice that is required;
    - (ii) do not have any interest that conflicts, or would appear to conflict, with that of the charity; and
- (4) the statutory requirement that charity trustees advertise the proposed disposition in the manner advised in the surveyor's report be removed.

**[Paragraph 7.175]**



### **Recommendation 15.**

16.15 We recommend that Part 7 of the Charities Act 2011 only apply where land is solely held by, or held in trust solely for, a single charity.

**[Paragraph 7.183]**

### **Recommendation 16.**

16.16 We recommend that:

- (1) the connected persons regime in Part 7 of the Charities Act 2011 be retained;
- (2) the definition of connected persons should:
  - (a) exclude employees where the disposal is the grant of a short residential tenancy;
  - (b) exclude wholly-owned subsidiaries;
  - (c) be capable of amendment by secondary legislation; and
  - (d) omit the reference to “illegitimate child”;
- (3) disposals of land to wholly-owned subsidiaries should be notified to the Charity Commission; and
- (4) the Charity Commission’s guidance for trustees disposing of land, and guidance for designated advisers, should make clear that disposals to wholly-owned subsidiaries should be for the best terms that can reasonably be obtained for the charity.

**[Paragraph 7.214]**

### **Recommendation 17.**

16.17 We recommend that:

- (1) charities be required to include in a contract for a disposition of charity land a statement that the requirements of Part 7 of the Charities Act 2011 have been complied with; and
- (2) a contract for a disposition of charity land should be enforceable by a purchaser if:
  - (a) such a certificate has been given in the contract; or
  - (b) such a certificate has not been given but the purchaser has acted in good faith.

**[Paragraph 7.227]**

### **Recommendation 18.**

16.18 We recommend that the requirements in section 121 of the Charities Act 2011 concerning advertising proposed disposals of designated land and considering any responses received should be abolished.

**[Paragraph 7.231]**

### **Recommendation 19.**

16.19 We recommend that the Charity Commission amend its guidance *Acquiring Land* (CC33) as follows.

- (1) The guidance should reflect our recommendations to reform the regime governing the disposal of land, for example, suggesting that advice could be obtained from a fellow of the National Association of Estate Agents or a fellow of the Central Association of Agricultural Valuers as well as a member of the Royal Institution of Chartered Surveyors.
- (2) The guidance should explain that trustees might decide not to obtain advice from those advisers, or from any advisers, with examples of when the trustees might make such a decision.
- (3) The suggestion that trustees seek advice on whether the proposed acquisition is in the interests of the charity should be removed.

**[Paragraph 7.243]**

### **Recommendation 20.**

16.20 We recommend that:

- (1) disposals of land by liquidators, provisional liquidators, administrators, receivers and mortgagees be excluded from Part 7 of the Charities Act 2011; and
- (2) the exception in section 117(3)(c) of the Charities Act 2011 be reformulated such that it applies only to disposals that are solely intended to further the transferor charity's purposes.

**[Paragraph 7.263]**

### **Recommendation 21.**

16.21 We recommend that:

- (1) the detailed provisions in the Universities and College Estates Act 1925 be repealed and the institutions to which it applies be given the general powers of an owner similarly to trustees under the Trusts of Land and Appointment of Trustees Act 1996 and the Trustee Act 2000; and
- (2) the exercise of that replacement power should not, of itself, engage the exception from the Part 7 advice requirements in section 117(3)(a) of the Charities Act 2011.

**[Paragraph 7.283]**

### **Recommendation 22.**

16.22 We recommend that the definition of permanent endowment in section 353 of the Charities Act 2011 be reformulated to remove its inconsistencies and lack of clarity.

**[Paragraph 8.33]**

### **Recommendation 23.**

16.23 We recommend that:

- (1) the power to release permanent endowment restrictions in sections 281 and 282 of the Charities Act 2011 should be available to all charities, and the potential exclusion of corporate charities should be removed;
- (2) the power to release permanent endowment restrictions in section 281 should depend on the value of the permanent endowment alone, and the income threshold and the “entirely given” condition in section 282(1) should be removed;
- (3) the power to release permanent endowment restrictions under section 281 should be available in respect of permanent endowment funds of a value up to £25,000;
- (4) the time limit for the Charity Commission to respond to a resolution under section 282:
  - (a) should be reduced to 60 days;
  - (b) should commence when the resolution is received by the Charity Commission;
  - (c) (when the Commission directs the charity trustees to give public notice of the resolution) should be suspended until 42 days after public notice is given;
  - (d) (when the Commission directs the charity trustees to provide further information about the resolution) should be suspended until that information is provided to the Commission; and
- (5) the parallel regime for “special trusts” in sections 288 and 289 of the Charities Act 2011 should be repealed.

**[Paragraph 8.96]**

### **Recommendation 24.**

16.24 We recommend that:

- (1) trustees be given a statutory power to borrow from their permanent endowment by allowing them to resolve to spend up to 25% of the value of the permanent endowment subject to a requirement that they recoup that expenditure within 20 years; and

- (2) trustees be given a power, once they have opted into the regulations governing total return investment, to resolve that the permanent endowment restrictions be further released to permit them to make social investments with a negative or uncertain financial return (which would not otherwise be permitted as “investments”).

**[Paragraph 8.145]**

**Recommendation 25.**

16.25 We recommend that:

- (1) the power in section 185 of the Charities Act 2011 allowing charities to remunerate trustees for the supply of services should be extended to allow charities to remunerate trustees for the supply of goods; and
- (2) the power should supplement any existing express power in the charity’s governing document (whether narrower or wider) to pay the remuneration.

**[Paragraph 9.12]**

**Recommendation 26.**

16.26 We recommend that:

- (1) the Charity Commission should have a power to require a charity to remunerate a trustee (or to authorise a trustee to retain a benefit already received) where:
  - (a) the trustee has done work for the charity; and
  - (b) it would be inequitable for the trustee not to be remunerated for that work (or not to retain the benefit received in connection with that work);
- (2) the exercise of that power, and the decision not to exercise the power, should be subject to challenge by way of judicial review.

**[Paragraph 9.38]**

**Recommendation 27.**

16.27 We recommend that the basis on which decisions of the Charity Commission can be challenged, including in particular the rights of challenge to the Charity Tribunal, should be reviewed.

**[Paragraph 9.40]**

**Recommendation 28.**

16.28 We recommend:

- (1) the introduction of a new statutory power allowing trustees to make small ex gratia payments without having to obtain the prior authorisation of the Charity Commission, the Attorney General or the court;

- (2) that the statutory power to make ex gratia payments without authorisation should apply to ex gratia payments of up to:
  - (a) £1,000, in the case of a charity with a gross income in its last financial year of up to £25,000;
  - (b) £2,500, in the case of a charity with a gross income in its last financial year of more than £25,000 and up to £250,000;
  - (c) £10,000, in the case of a charity with a gross income in its last financial year of more than £250,000 and up to £1 million; and
  - (d) £20,000, in the case of a charity with a gross income in its last financial year of more than £1 million;
- (3) that those financial thresholds should be capable of amendment by way of secondary legislation; and
- (4) that the statutory power to make small ex gratia payments should be capable of being expressly excluded or limited by a charity's governing document.

**[Paragraph 10.27]**

#### **Recommendation 29.**

16.29 We recommend that:

- (1) the test for making an ex gratia payment should be reformulated to allow such a payment to be made when the charity trustees could reasonably be regarded as being under a moral obligation to make it, thus allowing for the decision to make an ex gratia payment to be delegated; and
- (2) trustees should be able to delegate decisions to make ex gratia payments of any value to any person.

This recommendation applies when an ex gratia payment is to be made (i) without Charity Commission oversight under the new statutory power to make small payments (in accordance with Recommendation 28 above), and (ii) with Charity Commission oversight under section 106 of the Charities Act 2011.

**[Paragraph 10.46]**

#### **Recommendation 30.**

16.30 We recommend that:

- (1) the Attorney General, the court and the Charity Commission should have the power to authorise ex gratia payments by statutory charities; and
- (2) the power for charity trustees to make small ex gratia payments without Charity Commission approval should be available to statutory charities.

**[Paragraph 10.51]**

### **Recommendation 31.**

16.31 We recommend that decisions by the Charity Commission not to authorise an ex gratia payment under section 106 should be subject to review by the Charity Tribunal.

**[Paragraph 10.59]**

### **Recommendation 32.**

16.32 We recommend that the power in section 268 of the Charities Act 2011 (governed by sections 267 to 274 of the Act) be repealed.

**[Paragraph 11.48]**

### **Recommendation 33.**

16.33 We recommend that:

- (1) the first exclusion from section 310 vesting declarations (for land conveyed by way of mortgage for securing money subject to the trust) be repealed; and
- (2) leases containing absolute covenants against assignment be excluded from section 310 vesting declarations.

**[Paragraph 11.80]**

### **Recommendation 34.**

16.34 We recommend that:

- (1) when a charity has merged and the merger is registered, for the purposes of ascertaining whether a gift has been made to that charity under section 311(2) of the Charities Act 2011, the charity should be deemed to have continued to exist despite the merger;
- (2) when two or more CIOs amalgamate under section 235, for the purposes of ascertaining whether a gift has been made to the amalgamated CIO under section 239(3), the original CIOs should be deemed to have continued to exist despite the amalgamation;
- (3) when a CIO transfers its undertaking to another CIO under section 240, for the purposes of ascertaining whether a gift has been made to the transferee CIO under section 244(2), the transferor CIO should be deemed to have continued to exist despite the transfer; and
- (4) the Charity Commission should investigate whether, on registering a merger, a charity's entry in the register of charities could include a reference to the registered merger.

**[Paragraph 11.103]**

### **Recommendation 35.**

16.35 We recommend that:

- (1) trust corporation status be conferred automatically on existing and future corporate charities in respect of any charitable trust of which the corporation is (or, in the future, becomes) a trustee; and
- (2) regulation 61 of the Charitable Incorporated Organisations (General) Regulations 2012 be repealed.

**[Paragraph 11.136]**

### **Recommendation 36.**

16.36 We recommend that the guidance of the Charity Commission in *Managing a charity's finances* (CC12) be revised:

- (1) so as to make it clear that the availability of trust property, including trust property that falls within the statutory definition of "permanent endowment", "special trust" or "restricted funds", to meet the liabilities of an insolvent trustee is no different whether the trustee is an individual or a charitable company; and
- (2) to reflect more fully and accurately the law governing the exercise of trustees' rights of indemnity from trust property for the benefit of the creditors of the trustee, in particular in respect of permanent endowment, special trusts and restricted funds.

**[Paragraph 12.45]**

### **Recommendation 37.**

16.37 We recommend that:

- (1) the Charity Commission be empowered to issue a direction, relying on any ground in section 42(2) of the Charities Act 2011, requiring a charity to stop using a working name;
- (2) the Charity Commission be permitted to issue a direction, relying on the ground in section 42(2)(a):
  - (a) against both registered and unregistered charities; and
  - (b) where a charity's (formal or working) name is the same as, or too like, the working name (as well as the formal name) of another charity; and
- (3) the Charity Commission be permitted to issue a direction under section 42 to exempt charities.

**[Paragraph 13.43]**

### **Recommendation 38.**

16.38 We recommend that:

- (1) the Charity Commission be given a power to delay the registration of an institution as a charity, and to delay changing a charity's name in the register:
  - (a) during the period for compliance specified in a direction issued under section 42 of the Charities Act 2011; and
  - (b) for 60 days after that date for compliance; and
- (2) the 60 day period should stop running during any period that the following proceedings are ongoing:
  - (a) any challenge to (i) the section 42 direction, or (ii) any enforcement action taken by the Commission in respect of the section 42 direction; and
  - (b) any proceedings for contempt of court in respect of the section 42 direction.

**[Paragraph 13.60]**

### **Recommendation 39.**

16.39 We recommend that:

- (1) the Charity Commission be given the power to ratify prospectively the appointment or election of a person to a particular role (which in turn would render them a charity trustee);
- (2) the power should be exercisable only with the consent of the person whose appointment or election is sought to be ratified; and
- (3) a decision to ratify, or not to ratify, an appointment should be subject to challenge by way of judicial review.

**[Paragraph 14.29]**

### **Recommendation 40.**

16.40 We recommend that it should be possible to obtain authorisation to pursue "charity proceedings" under section 115 of the Charities Act 2011 from either the court or the Charity Commission in circumstances where the Charity Commission would face an actual or apparent conflict of interests if asked to give such authorisation.

**[Paragraph 15.18]**

### **Recommendation 41.**

16.41 We recommend that the Charity Tribunal be given the power to make "authorised costs orders" in respect of proposed or ongoing Tribunal proceedings that would provide charity trustees with advance assurance that:

- (1) costs already incurred or proposed to be incurred; and



(2) costs ordered to be paid if the litigation is unsuccessful;  
can properly be paid from the charity's funds.

**[Paragraph 15.47]**

**Recommendation 42.**

16.42 We recommend that the Charity Commission delay the date on which its decisions take effect to allow time for a challenge (to the Tribunal or to the court) where the decision is likely to be controversial and is not time-sensitive.

**[Paragraph 15.58]**

**Recommendation 43.**

16.43 We recommend that the Charity Commission should not be required to obtain the Attorney General's consent before making a reference to the Charity Tribunal, but that the Charity Commission and the Attorney General should be required to give the other four weeks' advance notice of any intended reference.

**[Paragraph 15.67]**

## Appendix 1: Selected Issues in Charity Law - Terms of Reference

1.1 This project was included in the Law Commission's Eleventh Programme of Law Reform.<sup>1193</sup> It will examine a range of issues concerning the constitution and regulation of charities and their activities, and areas of charity law that have been identified as causing uncertainty and carrying disproportionate regulatory or administrative burdens, with a view to making recommendations for technical law reform. These terms of reference have been drafted in the light of the technical points set out at Appendix A of Lord Hodgson's Report following the review of the Charities Act 2006.<sup>1194</sup> The project will consider the following areas.

- (1) *Charitable corporations established by Royal Charter.* We will consider reform in relation to the means by which the charter is amended.
- (2) *Charities with statutory governing documents.* We will consider less burdensome alternatives for the procedure to amend the provisions made by the statute in relation to the charity.
- (3) *Regulatory framework of certain charity transactions and dispositions.* We will consider areas in which it may be appropriate for charity trustees to have more autonomy, subject to appropriate safeguards; in particular:
  - (a) disposals of and the creation of charges over charity land;
  - (b) the application of property *cy-près* and associated issues, including the application of the proceeds of failed appeals;
  - (c) the making of *ex gratia* payments out of the charity's funds; and
  - (d) the remuneration of trustees for the provision of goods to the charity (where not provided in conjunction with a service).
- (4) *Charity Commission powers.* We will examine the possibility of reform to:
  - (a) enable the Charity Commission retrospectively to authorise an equitable allowance in respect of unauthorised benefits to charity trustees, which currently requires an application to court;
  - (b) enable the Charity Commission to require a charity to change its name as a precondition of registration; and
  - (c) the Charity Commission's powers to determine membership of a charity.

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<sup>1193</sup> Eleventh Programme of Law Reform (2011) Law Com No 330, paras 2.2 to 2.6.

<sup>1194</sup> *Trusted and independent: giving charity back to charities – Review of the Charities Act 2006* (July 2012).

- (5) *Powers of the Charity Tribunal.*<sup>1195</sup> We will consider:
- (a) whether the Tribunal should have the power (currently held by the Charity Commission) to authorise expenditure on proceedings before it;
  - (b) the procedure for references by the Charity Commission to the Tribunal;
  - (c) whether the rules relating to references to the Tribunal should be amended to include a list of powers exercisable by the Tribunal on determining a reference, including the power to award certain remedies; and
  - (d) whether the Tribunal should be empowered to suspend the effects of a Commission scheme or decision pending the determination of a case.
- (6) *Charity insolvency law.* We will review:
- (a) the current distinction between access to the permanently-endowed funds of charitable trusts, and those of corporate charities, to meet properly-incurred liabilities upon the charity's insolvency; and
  - (b) whether property held by an insolvent charity on a special charitable trust should be available for distribution amongst its creditors generally.
- (7) *Charity mergers and incorporations.* We will address the potential for reducing administrative burdens on charities wishing to merge or incorporate, in particular:
- (a) issues concerning gifts by will to charities which have merged;
  - (b) possible reform to the regime for the transfer of permanent endowment upon merger, and the assignability of leases and other rights to a merged charity; and
  - (c) whether the use of vesting declarations to transfer property and permanent endowment to another charity should be extended.
- (8) *Mixed-purpose social investment by charities.* We will consider, within the parameters of the current law on private benefit:
- (a) whether anything can be done by way of law reform to make clearer the powers and duties of charity trustees in undertaking mixed-purpose social investment, in particular whether to introduce a new specific investment power; and
  - (b) the introduction of a power for non-functional permanent endowment to be spent on mixed-purpose investments, with the requirement that capital levels must be maintained or otherwise restored within a reasonable period.

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<sup>1195</sup> By "Charity Tribunal" we mean both the General Regulatory Chamber of the First-tier Tribunal and the Tax and Chancery Chamber of the Upper Tribunal.

- (9) *Permanent endowment.* We will review the current powers to release the restrictions on spending permanent endowment and consider whether there are other approaches that would allow permanent endowment to be used more flexibly.

Updated 16 March 2015

## Appendix 2: List of consultees

Action with Communities in Rural England (ACRE)

Anthony Collins Solicitors LLP

Association of Charitable Foundations (ACF)

Association of Church Accountants & Treasurers (ACAT)

Association of Corporate Trustees (TACT)

Association of the Heads of University Administration (AHUA)

Attorney General's Office

Baptist Union of Great Britain

Bates Wells Braithwaite

Bircham Dyson Bell LLP

Canal & River Trust

Cancer Research UK

Central Association of Agricultural Valuers (CAAV)

Chancery Bar Association

Charities' Property Association

Charity Commission for England and Wales

Charity Commission for Northern Ireland

Charity Finance Group (CFG)

Charity Investors' Group

Charity Law and Policy Unit (University of Liverpool)

Charity Law Association (CLA) working parties:

- Nicola Evans, Bircham Dyson Bell LLP (Chair)
- Tracey Chippendale-Holmes (Chair)
- Sylvie Nunn, Wrigleys Solicitors LLP (Chair)
- Eva Abeles, IBB Law
- Catherine Beringer, Auxilium Advisers

Ian Blaney, Lee Bolton Monier-Williams  
Liz Brownsell, Blake Morgan  
Lynn Cadman, Illuminate Governance  
Neasa Coen, BLP LLP  
Richard Corden, Southampton Hospital Charity  
Andrew Crawford, Devonshires  
Giselle Davies, Geldards LLP  
Rebecca Fry, Farrer & Co<sup>1196</sup>  
Virginia Henley, Penningtons Manches  
Rachel Holmes, Farrer & Co  
Leah Hurst, British Council  
Natalie Johnson, Wrigleys Solicitors LLP  
Elizabeth Jones, Farrer & Co  
Clarissa Lyons, BLP LLP  
Jennifer Marley, Pennington Manches  
Reema Mathur, Stone King LLP  
James McCallum, Russell-Cooke  
Kirsty McEwen, Higgs and Sons  
Robert Pearce QC, Radcliffe Chambers  
Nicholas Pell, Macfarlanes LLP  
Chris Priestley, Withers LLP  
Samantha Pritchard, Bond Dickinson  
Lucy Rhodes, Bates Wells Braithwaite  
Martyn Robinson, Hewitsons  
Nigel Roots, Freeths  
Sarah Rowley, Charles Russell Speechlys LLP  
Catherine Rustomji, DWF LLP  
Laura Soley, Bates Wells Braithwaite  
Anna Sumner, Withers LLP  
Alison Talbot, Penningtons Manches  
Geoffrey Trobridge, Lester Aldridge LLP  
Bethan Walsh, Geldards LLP  
Emma-Jane Weider, Maurice Turnor Gardner  
Alexandra Whittaker, Stone King LLP

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<sup>1196</sup> Rebecca Fry was a member of the CLA working party that responded to the main consultation in 2015, before she joined the Charity Commission.

Hannah Whyatt, Farrer & Co

Church Growth Trust

Churches' Legislation Advisory Service (CLAS)

City of London Corporation as trustee of Bridge House Estates

Cluttons LLP

Colleges of the University of Cambridge

Colleges of the University of Oxford

Department for Business, Innovation and Skills (as it then was)

Durham University

Crispin Ellison (adviser), Legacy Link

Gerald Eve LLP

Fellowship of Independent Evangelical Churches (FIEC)

Geldards LLP

General Medical Council

Guy's and St Thomas' Charity

William Henderson (barrister)

Higher Education Funding Council for England (HEFCE)

Lord Hodgson of Astley Abbotts CBE

Imperial College London

Incorporated Church Building Society

Independent Schools Council

Institute of Chartered Secretaries and Administrators

Institute of Directors

Institute of Fundraising (IoF)

Institute of Legacy Management

Institution of Civil Engineers

Val James (solicitor)

Jurisdiction and Procedure Branch, Justice Policy Group (Ministry of Justice)

Land Registry

Landmark Trust

Law Society

Keith Lawrey (adviser)

Lawyers in Charities (LinC)

Methodist Church

Joel Moreland (adviser)

Professor Gareth Morgan (Sheffield Hallam University)

Dr John Picton

National Council for Voluntary Organisations (NCVO)

National Trust

Office of the Scottish Charity Regulator (OSCR)

Open University

Overseas Development Institute

Robert Pearce QC (barrister)

Hubert Picarda QC (barrister)

Pinsent Masons LLP

Plymouth University

Privy Council Office

Francesca Quint (barrister)

Monsignor Nicholas Rotherham

Royal Archaeological Institute

Royal Institution of Chartered Surveyors (RICS)

Royal Photographic Society

Royal Statistical Society

RSPCA



Patrick Ryan (member of the public)

Professor Duncan Sheehan

Social Finance

Society for Radiological Protection

Stewardship

Stone King LLP

Sustrans and Railway Paths

Dr Mary Synge (Cardiff University)

Trowers and Hamlins LLP

Professor Janet Ulph (University of Leicester)

United Reformed Church, Yorkshire Synod

University College London

University of Birmingham

University of Cambridge

University of Oxford

University of Warwick

UnLtd

Veale Wasbrough Vizards LLP

Wales Council for Voluntary Action (WCVA)

Wellcome Trust

Welsh Government

Withers LLP

# Charities Bill

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**B I L L**

TO

Amend the Charities Act 2011 and the Universities and College Estates Act 1925; and for connected purposes

**B**E IT ENACTED by the Queen’s most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

**PART 1**

PURPOSES, POWERS AND GOVERNING DOCUMENTS

*Charitable companies*

**1 Alteration of charitable company’s purposes**

- (1) Section 198 of the Charities Act 2011 (alteration of objects by companies and Commission’s consent) is amended as follows. 5
- (2) In subsection (2)(a) for the words from “adding” to the end of the paragraph substitute “which alters the charitable purposes of the company,”.
- (3) After subsection (2) insert—
- “(2A) In considering whether to consent to an alteration falling within subsection (2)(a) the Commission must have regard to— 10
- (a) the purposes of the company when it was established,
  - (b) the desirability of securing that the purposes of the company are, so far as reasonably practicable, similar to the purposes being altered, and 15
  - (c) the need for the company to have purposes which are suitable and effective in the light of current social and economic circumstances.”

## CIOs

**2 Amendments to constitution of CIOs**

- (1) The Charities Act 2011 is amended as follows.
- (2) In section 224 (amendment of constitution and procedure), after subsection (3) insert – 5
- “(4) Within 15 days of the date of passing such a resolution the CIO must send to the Commission a copy of the resolution together with –
- (a) a copy of the constitution as amended;
- (b) such other documents and information as the Commission may require.” 10
- (3) In section 226 (amendment of constitution and Commission’s consent) –
- (a) for subsection (1) substitute –
- “(1) An amendment to a CIO’s constitution which would make a regulated alteration –
- (a) requires the prior written consent of the Commission, 15  
and
- (b) cannot take effect if such consent has not been obtained,  
(and subsections (2B) and (2C) are subject to this requirement.”;
- (b) after subsection (2) insert –
- “(2A) In considering whether to consent to an alteration falling within 20  
subsection (2)(a) the Commission must have regard to –
- (a) the purposes of the CIO when it was established,
- (b) the desirability of securing that the purposes of the CIO  
are, so far as reasonably practicable, similar to the  
purposes being altered, and 25
- (c) the need for the CIO to have purposes which are suitable  
and effective in the light of current social and economic  
circumstances.
- (2B) Subject to subsection (2C), an amendment to a CIO’s  
constitution takes effect – 30
- (a) on the date the resolution containing it is passed, or
- (b) if a later date is specified for that purpose in the  
resolution containing the amendment, on that later date.
- (2C) An amendment making a regulated alteration falling within  
subsection (2)(a) takes effect – 35
- (a) when it is registered by the Commission, or
- (b) if later, on the date specified for that purpose in the  
resolution containing the amendment.”;
- (c) in the heading for “and Commission’s consent” substitute “:  
Commission’s consent and coming into effect”. 40
- (4) Omit section 227.

*Unincorporated charities*

**3 Powers of unincorporated charities**

- (1) Omit sections 267 to 280 of the Charities Act 2011 (which together deal with powers to transfer the property of, and alter the purposes or powers of, an unincorporated charity). 5
- (2) Before the italic heading above section 281 of that Act insert –

*“Unincorporated charity’s general power to amend*

**280A Amendment of the trusts of an unincorporated charity**

- (1) This section applies to any charity which is not a company or other body corporate. 10
- (2) The charity trustees of such a charity may, if they are satisfied that it is expedient in the interests of the charity, resolve that the trusts of the charity should be amended in such manner as is specified in the resolution.
- (3) The power under subsection (2) is not exercisable in any way which would result in the institution ceasing to be a charity. 15
- (4) Subsection (5) applies in the case of a charity which has a body of members distinct from the charity trustees, any of whom are entitled under the trusts of the charity to attend and vote at a general meeting of the body. 20
- (5) In the case of a charity to which this subsection applies, a resolution under subsection (2) is effective only if –
- (a) it is passed by a majority of the charity trustees of the charity, and
  - (b) it is approved by a further resolution which is passed – 25
    - (i) at a general meeting, by not less than 75% of the members entitled to attend and vote at the meeting who vote on the resolution,
    - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the meeting, or 30
    - (iii) otherwise than at a general meeting, by the agreement of all the members entitled to attend and vote at a general meeting.
- (6) In the case of any other charity, a resolution under subsection (2) is effective only if it is passed by not less than 75% of the charity trustees of the charity. 35
- (7) An amendment to which subsection (8) applies –
- (a) requires the written consent of the Commission, and
  - (b) is ineffective if such consent has not been obtained. 40
- (8) This subsection applies to an amendment –
- (a) which would alter the purposes of the charity;

- (b) which would alter a provision directing the application of property of the charity on its dissolution;
- (c) which would provide authorisation for any benefit to be obtained by charity trustees or members of the charity, or persons connected with them; 5
- (d) which would alter a restriction making property permanent endowment;
- (e) which would require the consent of a person other than –  
 (i) a charity trustee of, or trustee for, the charity, or  
 (ii) a member of the charity, 10  
 if made otherwise than by virtue of this section;
- (f) which would affect any right directly conferred by the trusts of the charity on a person who –  
 (i) is named in the trusts of the charity, or  
 (ii) holds an office or other position specified in the trusts of the charity (other than that of charity trustee or member of, or trustee for, the charity); 15
- (g) which would confer power on the charity trustees to make an amendment falling within any of paragraphs (a) to (f).
- (9) But subsection (8)(e) and (f) do not apply where the person concerned consents to the amendment or is no longer in existence. 20
- (10) In considering whether to consent to an alteration falling within subsection (8)(a), or to the conferral of a power which would enable the charity trustees to make such an alteration, the Commission must have regard to – 25
- (a) the purposes of the charity when it was established,  
 (b) the desirability of securing that the purposes of the charity are, so far as reasonably practicable, similar to the purposes being altered, and  
 (c) the need for the charity to have purposes which are suitable and effective in the light of current social and economic circumstances. 30

#### **280B S. 280A: supplementary provision**

- (1) A resolution under section 280A(2) takes effect on the latest of – 35
- (a) the date the resolution is passed,  
 (b) the date specified in the resolution for it to take effect,  
 (c) if relevant, the date on which the resolution required by virtue of section 280A(5)(b) is passed, and  
 (d) if relevant, the date on which the Commission gives any consent required by virtue of section 280A(7). 40
- (2) In section 280A(8)(c) “benefit” means a direct or indirect benefit of any nature, except that it does not include –
- (a) any remuneration whose receipt may be authorised under section 185, or  
 (b) the purchase of any insurance which may be authorised under section 189. 45
- (3) For the purposes of section 280A(8)(c) the following persons are connected with a charity trustee or a member of a charity –



- (a) a child, parent, grandchild, grandparent, brother or sister of the trustee or member;
  - (b) the spouse or civil partner of the trustee or member or of any person falling within paragraph (a);
  - (c) a person carrying on business in partnership with the trustee or member or with any person falling within paragraph (a) or (b);
  - (d) an institution which is controlled –
    - (i) by the trustee or member or by any person falling within paragraph (a), (b) or (c), or
    - (ii) by two or more persons falling within sub-paragraph (i), when taken together;
  - (e) a body corporate in which –
    - (i) the trustee or member or any connected person falling within any of paragraphs (a) to (c) has a substantial interest, or
    - (ii) two or more persons falling within sub-paragraph (i), when taken together, have a substantial interest.
- (4) Sections 350 to 352 (meaning of child, spouse, civil partner, controlled institution and substantial interest) apply for the purposes of subsection (3).”
- (3) The amendments made by this section do not have effect in respect of a resolution passed under section 268(1), 275(2) or 280(2) of the Charities Act 2011 before the commencement of this section.

*Charities established etc by Act or Royal charter*

**4 Power to amend Royal charter**

After section 280B of the Charities Act 2011 (as inserted by section 3) insert –

*“Charity established etc by Royal charter: general power to amend*

**280C Power to amend Royal charter**

- (1) This section applies to any charity which is established or regulated by Royal charter.
- (2) The charity trustees of such a charity may resolve that the Royal charter should be amended in such manner as is specified in the resolution if –
  - (a) they are satisfied that it is expedient in the interests of the charity to do so, and
  - (b) there is no power under the Royal charter to make the proposed amendment.
- (3) Subsection (4) applies in the case of a charity which has a body of members distinct from the charity trustees, any of whom are entitled under the Royal charter to attend and vote at a general meeting of the body.
- (4) In the case of a charity to which this subsection applies, a resolution under subsection (2) may not be approved under subsection (6) unless –

- (a) it is passed by a majority of the charity trustees of the charity, and
- (b) it is approved by a further resolution which is passed –
  - (i) at a general meeting, by not less than 75% of the members entitled to attend and vote at the meeting who vote on the resolution, 5
  - (ii) at a general meeting, by a decision taken without a vote and without any expression of dissent in response to the question put to the meeting, or
  - (iii) otherwise than at a general meeting, by the agreement of all the members entitled to attend and vote at a general meeting. 10
- (5) In the case of any other charity to which this section applies, a resolution under subsection (2) may not be approved under subsection (6) unless it is passed by not less than 75% of the charity trustees of the charity. 15
- (6) A resolution under this section takes effect when it is approved by Her Majesty by Order in Council.”

## 5 Orders under section 73 of the Charities Act 2011: parliamentary procedure

In section 73 of the Charities Act 2011 (powers to make schemes altering provision made by Acts, etc) – 20

- (a) omit subsections (3), (4) and (6);
- (b) in subsection (5), omit “Subject to subsection (6),”.

### *Cy-près and schemes*

## 6 Cy-près powers 25

- (1) For sections 63 to 65 of the Charities Act 2011 (which deal with the application of property cy-près) substitute –

### “63A Failure of specific charitable purposes: application cy-près

- (1) Property given for specific charitable purposes which fail is applicable cy-près as if given for charitable purposes generally, if – 30
  - (a) the court or the Commission by order so direct, or
  - (b) the condition specified in any of subsections (3), (4) or (6) is met.
- (2) An order may be made under subsection (1)(a) if it appears to the court or the Commission –
  - (a) that it would be unreasonable, having regard to the amounts likely to be returned to the donors, to incur expense with a view to returning the property, or 35
  - (b) that it would be unreasonable, having regard to the nature, circumstances and amounts of the gifts, and to the lapse of time since the gifts were made, for the donors to expect the property to be returned. 40
- (3) The condition in this subsection is met if –
  - (a) the property is a single gift of £120 or less, and

- (b) the charity trustees reasonably believe that during the financial year of the charity in which it is given the total amount given by the donor to the charity for the specific charitable purposes is £120 or less,  
unless at the time of giving the gift the donor states in writing that the gift must be returned if the specific charitable purposes fail. 5
- (4) The condition in this subsection is met if the property is given by a donor who, after the agreed actions are taken, is not identified or is not found.
- (5) The “agreed actions” are those agreed in writing between the charity trustees and the Commission as being reasonable in all the circumstances of the case to identify and find donors. 10
- (6) The condition in this subsection is met if the property consists of –  
(a) the proceeds of cash collections made –  
(i) by means of collecting boxes, or 15  
(ii) by other means not adapted for distinguishing one gift from another, or  
(b) the proceeds of any lottery, competition, entertainment, sale or similar money-raising activity, after allowing for property given to provide prizes or articles for sale or otherwise to enable the activity to be undertaken. 20
- (7) The Secretary of State may by regulations amend subsection (3)(a) or (b) by substituting a different sum for the time being specified there.”
- (2) The Charities (Failed Appeals) Regulations 2008 (S.I. 2008/56) are revoked.
- (3) The amendments made by this section apply to property given for charitable purposes whenever it is given. 25

## 7 Proceeds of fund-raising: power of trustees to apply cy-près

After section 67 of the Charities Act 2011 insert –

### “67A Proceeds of fund-raising: power of trustees to apply cy-près

- (1) Subsection (2) applies if – 30  
(a) money or other property is solicited to enable a charity to further specific charitable purposes,  
(b) money or other property is given as a result of that solicitation, and  
(c) some or all of that money or other property (or the property for the time being representing it or derived from it) is applicable cy-près by virtue of section 62(1)(a) or (b) or 63A. 35
- (2) The charity trustees of the charity may resolve that all the money or other property which is applicable cy-près by virtue of section 62(1)(a) or (b) or 63A be applied for such charitable purposes specified in the resolution as they consider appropriate, having regard to – 40  
(a) the desirability of securing that the purposes are, so far as reasonably practicable, similar to the specific charitable purposes for which the money or other property was given;

- (b) the need for the purposes to be suitable and effective in the light of current social and economic circumstances.
- (3) A resolution under this section must be passed by a majority of the charity trustees.
- (4) If a resolution passed under this section concerns money or other property with a value exceeding £1,000— 5
- (a) the charity trustees must send a copy of the resolution to the Commission, together with a statement of their reasons for passing it, and
- (b) the resolution does not have effect until the date on which the Commission consents to it in writing. 10
- (5) The Secretary of State may, by regulations, amend subsection (4) by substituting a different sum for the sum for the time being specified there.”
- 8 Power of the court and the Commission to make schemes 15**
- Before the italic heading above section 75A of the Charities Act 2011 insert—
- “Power of the court and the Commission to make schemes*
- 75ZA Power of the court and the Commission to make schemes**
- (1) Any power of the court or the Commission to make a scheme in relation to a charity that is a charitable trust is also exercisable in relation to any other institution which is a charity. 20
- (2) Subsection (1)—
- (a) is subject to the provisions of this Act;
- (b) is to be treated as always having had effect.”
- Permanent endowment* 25
- 9 Definition of “permanent endowment”**
- In section 353 of the Charities Act 2011 (minor definitions), for subsection (3) substitute—
- “(3) For the purposes of this Act, property is “permanent endowment” if it is subject to a restriction on being expended which distinguishes between income and capital.” 30
- 10 Amendment of powers to release restrictions on spending capital**
- (1) In section 281 of the Charities Act 2011 (power of unincorporated charities to spend capital: general), omit “which is not a company or other body corporate”. 35
- (2) In section 282 of that Act (resolution to spend larger fund given for particular purpose)—
- (a) in the heading, omit “given for particular purpose”;

- (b) in subsection (1), for the words from “which is not” to the end of the subsection substitute “if the market value of the fund exceeds £25,000”;
- (c) omit subsection (6).

## **11 Taking effect of resolution under section 282 of the Charities Act 2011**

- (1) Section 284 of the Charities Act 2011 (taking effect of resolution under section 282) is amended as follows. 5
- (2) In subsection (3), for “period of 3 months beginning with the relevant date” substitute “relevant period”.
- (3) For subsection (4) substitute –
  - “(4) The “relevant period” means – 10
    - (a) the period of 60 days beginning with the date on which the Commission receives the copy of the resolution in accordance with section 282(4), or
    - (b) that period as modified by subsection (4A) or (4B).
  - (4A) If under section 283(1) the Commission directs the charity trustees to give public notice of a resolution, the running of the relevant period is suspended from the date on which the direction is given to the charity trustees until the end of the period of 42 days beginning with the date on which public notice of the resolution is given by the charity trustees. 15
  - (4B) If under section 283(2) the Commission directs the charity trustees to provide any information or explanations, the running of the relevant period is suspended from the date on which the direction is given to the charity trustees until the date on which the information or explanations is or are provided to the Commission.” 20

## **12 Power to borrow from permanent endowment** 25

- (1) The Charities Act 2011 is amended as follows.
- (2) After section 284 insert –

### *“Power to borrow from permanent endowment*

#### **284A Power to borrow from permanent endowment: general**

- (1) This section applies to any available endowment fund of a charity. 30
- (2) The charity trustees may resolve to borrow an amount, not exceeding the permitted amount, from the available endowment fund if they are satisfied –
  - (a) that it is expedient for the amount to be borrowed, and
  - (b) that arrangements are in place for the amount to be repaid 35
    - within 20 years of being borrowed.
- (3) Any amount borrowed in accordance with subsection (2) no longer forms part of the available endowment fund and, as a result, is freed from the restrictions with respect to the expenditure of capital that applied to it when it was comprised in that fund. 40

- (4) An amount borrowed in accordance with subsection (2) may not be used to repay (in whole or in part) any amount previously borrowed from permanent endowment (whether the previous borrowing was by virtue of this section or otherwise).
- (5) When repaying an amount borrowed (whether in whole or in part), the charity trustees may resolve to pay an additional amount not exceeding the maximum estimated capital appreciation. 5
- (6) Any –  
 (a) repayment of an amount borrowed, and  
 (b) payment of an additional amount by virtue of a resolution under subsection (5), 10  
 is to be added to the available endowment fund and is to be subject to the same restrictions as to expenditure as apply to the other capital in the fund.
- (7) The powers conferred by this section – 15  
 (a) may be restricted or excluded by the trusts of the charity;  
 (b) are (subject to paragraph (a)) in addition to any other power to borrow that the charity or charity trustees may have.
- (8) If, and in so far as, the power conferred by subsection (5) confers power to accumulate income, it is not subject to section 14(3) of the Perpetuities and Accumulations Act 2009 (which provides for certain powers to accumulate income to cease after 21 years). 20
- (9) In this section “available endowment fund”, in relation to a charity, means –  
 (a) the whole of the charity’s permanent endowment if it is all subject to the same trusts, or 25  
 (b) any part of its permanent endowment which is subject to any particular trusts that are different from those to which any other part is subject.
- (10) If a resolution under section 104A(2) has effect in respect of an available endowment fund (or portion of such a fund), references in this section to an “available endowment fund” include that fund (or portion) but do not include any returns from the investment of the fund (or portion) which have not been accumulated. 30
- (11) For the meaning of “permitted amount” and “maximum estimated capital appreciation” see sections 284B and 284C respectively. 35

#### **284B Calculation of the “permitted amount”**

- (1) The “permitted amount” for the purposes of section 284A(2) is given by the formula –

$$(0.25 \times (V + B)) - B \quad 40$$

where –

V is the value of the available endowment fund on the relevant date (ignoring the value, if any, of the benefit of the debt owed by the charity trustees representing outstanding borrowing from the fund), and

B is the amount of the charity trustees' outstanding borrowing from the available endowment fund on that date. 5

- (2) In subsection (1) –  
the “relevant date” is the date on which the trustees resolve to borrow from the available endowment fund (see section 284A(2)); 10  
“outstanding borrowing” means outstanding borrowing by virtue of section 284A or otherwise.
- (3) If a resolution under section 104A(2) has effect in respect of the available endowment fund (or any part of it), for the purposes of subsection (1) the value of the available endowment fund does not include any returns from the investment of the fund (or part) which have not been accumulated. 15

#### **284C Calculation of the “maximum estimated capital appreciation”**

- (1) The “maximum estimated capital appreciation” for the purposes of section 284A(5) is given by the formula – 20

$$R \times I$$

where –

R is the amount of borrowing being repaid, and  
I is the percentage increase in the relevant index between the month in which the amount was borrowed and the month preceding the month in which the repayment is made (or if there is no increase is nil). 25

- (2) The “relevant index” is whichever of the following is selected by the charity trustees from time to time – 30
- (a) the retail prices index;
  - (b) the consumer prices index;
  - (c) any similar general index of prices published by the Statistics Board.

- (3) In this section –  
“retail prices index” means the general index of retail prices (for all items) published by the Statistics Board; 35  
“consumer prices index” means the general index for consumer prices published by the Statistics Board.

#### **284D Inability to repay**

- (1) If (at any time) it appears to the charity trustees that – 40
- (a) they will not be able to fulfil the arrangements put in place to repay an amount borrowed under section 284A, or
  - (b) those arrangements are not sufficient to ensure that the amount is repaid,
- the trustees must apply to the Commission for an order under this section directing them how to proceed. 45

- (2) An order under this section may give such directions as the Commission thinks fit, including –
- (a) that the relevant amount may be repaid over a longer period,
  - (b) that the charity trustees put in place arrangements specified in the order, or
  - (c) that the charity trustees need not repay an amount borrowed.” 5
- (3) In section 285 (power to alter sums specified in Part 13), after subsection (2) insert –
- “(3) The Secretary of State may by regulations amend –
- (a) the period of time specified in section 284A(2)(b), or
  - (b) the multiplier in the formula set out in section 284B(1),
- so as to substitute a different time period or multiplier (as the case may be) for the period or multiplier for the time being specified in that provision.” 10
- 13 Total return investment** 15
- (1) The Charities Act 2011 is amended as follows.
- (2) After section 104A insert –
- “104AA Total return investment: social investments**
- (1) This section applies to a fund, or a portion of a fund, in respect of which a resolution under section 104A(2) has effect (a “total return fund”). 20
- (2) The charity trustees may resolve that a total return fund (and any returns from the investment of the total return fund) may be used to make social investments (within the meaning of section 292A) which they could not otherwise make.
- (3) While a resolution under subsection (2) has effect, regulations under section 104B(1)(b) and (ba) apply to the total return fund (and any returns from it).” 25
- (3) In section 104B (total return investment: regulations) –
- (a) in subsection (1)(a), for “section 104A(2)” substitute “sections 104A(2) and 104AA(2)”; 30
  - (b) omit the “and” following subsection (1)(b);
  - (c) after subsection (1)(b), insert –
    - “(ba) the use of a total return fund to make social investments (within the meaning of section 292A), and”;
  - (d) in subsection (1)(c), after “104A(2)” insert “or 104AA(2)”; 35
  - (e) in subsection (2)(a), after “104A(2)” insert “or 104AA(2)”.

*Special trusts***14 Special trusts**

- (1) Omit Part 14 of the Charities Act 2011 (special trusts).
- (2) In section 353 of that Act (minor definitions), after subsection (3) insert – 40
- “(4) In this Act, “special trust” means property which –



- (a) is held and administered by or on behalf of a charity for any special purposes of the charity, and
  - (b) is so held and administered on separate trusts relating only to that property.
- But a special trust does not, by itself, constitute a charity for the purposes of Part 8 (charity accounts, reports and returns).”

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*Ex gratia payments etc*

**15 Small ex gratia payments**

In Part 18 of the Charities Act 2011 (miscellaneous and supplementary), before the italic heading immediately preceding section 332 insert –

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*“Limited power to make ex gratia payments*

**331A Limited power for charity trustees to make ex gratia payments etc**

- (1) The charity trustees of a charity may take any action falling within subsection (2)(a) or (b) if the conditions in subsection (3) are met.
- (2) The actions are –
  - (a) making any application of property of the charity, or
  - (b) waiving to any extent, on behalf of the charity, its entitlement to receive any property.
- (3) The conditions are –
  - (a) that the value of the property does not exceed the relevant threshold,
  - (b) that the charity trustees have no power to take the action apart from this section or by virtue of section 106, and
  - (c) that in all the circumstances the charity trustees could reasonably be regarded as being under a moral obligation to take the action.
- (4) The power conferred by this section may be restricted or excluded by the trusts of the charity.
- (5) In relation to a charity established by (or whose purposes or functions are set out in) legislation, the power conferred by this section is not disapplied only because the legislation concerned prohibits application of property of the charity otherwise than as set out in the legislation.
- (6) For the purposes of subsection (3)(a) –
  - (a) if the charity’s gross income in its last financial year did not exceed £25,000, the relevant threshold is £1,000;
  - (b) if the charity’s gross income in its last financial year exceeded £25,000 but not £250,000, the relevant threshold is £2,500;
  - (c) if the charity’s gross income in its last financial year exceeded £250,000 but not £1 million, the relevant threshold is £10,000;
  - (d) if the charity’s gross income in its last financial year exceeded £1 million, the relevant threshold is £20,000.
- (7) In subsection (5) “legislation” means –

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- (a) an Act of Parliament or an Act or Measure of the National Assembly for Wales;
- (b) subordinate legislation (within the meaning of the Interpretation Act 1978) made under such an Act or Measure; or
- (c) a Measure of the Church Assembly or of the General Synod of the Church of England.” 5

### **331B Power to alter sums specified in s.331A**

The Secretary of State may by regulations amend section 331A(6) (relevant income thresholds) by substituting a different sum for any sum for the time being specified in that provision.” 10

## **16 Power of Commission etc to authorise ex gratia payments etc**

In section 106 of the Charities Act 2011 (power for Commission to authorise ex gratia payments etc) –

- (a) for subsection (1) substitute –

“(1) The Commission, the Attorney General or the court may authorise the charity trustees of a charity to take any action falling within subsection (2)(a) or (b) in a case where the charity trustees – 15

- (a) (apart from by virtue of this section or section 331A) have no power to take the action, but 20
- (b) in all the circumstances could reasonably be regarded as being under a moral obligation to take it.

(1A) In relation to a charity established by (or whose purposes or functions are set out in) legislation, subsection (1) is not disapplied only because the legislation concerned prohibits application of property of the charity otherwise than as set out in the legislation. 25

(1B) In subsection (1) “legislation” means –

- (a) an Act of Parliament or an Act or Measure of the National Assembly for Wales; 30
- (b) subordinate legislation (within the meaning of the Interpretation Act 1978) made under such an Act or Measure; or
- (c) a Measure of the Church Assembly or of the General Synod of the Church of England.”; 35

- (b) in subsection (3), after second “Commission” insert “by order and”.

## **PART 2**

### **CHARITY LAND**

#### *Dispositions and mortgages*

## **17 Scope of Part 7 of the Charities Act 2011 40**

In section 117 of the Charities Act 2011 (restrictions on dispositions of land:

general), after subsection (1) insert –

“(1A) For the purposes of this Part, land is held by or in trust for a charity only if the whole of the land which forms the subject matter of the disposition is held –

- (a) by the charity solely for its own benefit (and, accordingly, is not being held as nominee or in trust for another person), or 5
- (b) in trust solely for the charity.”

## 18 Exceptions to restrictions on dispositions or mortgages of charity land

(1) The Charities Act 2011 is amended as follows.

(2) In section 117(3) (exceptions to restrictions on dispositions of charity land) – 10

(a) after paragraph (a) insert –

“(aa) any disposition by a liquidator, provisional liquidator, receiver, mortgagee or an administrator.”;

(b) omit paragraph (b);

(c) for paragraph (c) (but not the “or” following it) substitute – 15

“(c) any disposition of land held by or in trust for a charity which is made to another charity unless –

(i) the charity making the disposition is making it with a view to achieving the best price it can reasonably obtain, or 20

(ii) the disposition is a social investment for the purposes of Part 14A (social investments).”

(3) In section 124(9) (restrictions on mortgages) –

(a) after paragraph (a) insert –

“(aa) granted by a liquidator, provisional liquidator, receiver, mortgagee or an administrator.”; 25

(b) omit paragraph (b).

## 19 Repeal of section 121 of the Charities Act 2011

(1) Omit section 121 of the Charities Act 2011 (additional restrictions where land held for stipulated purposes). 30

(2) Schedule 1 (which contains consequential amendments) has effect.

## 20 Advertising and report requirements for disposition of charity land

In section 119 of the Charities Act 2011 (requirements for dispositions other than certain leases) –

(a) omit subsection (1)(b) (but not the “and” following it); 35

(b) in subsection (4), omit “contain such information, and” and the “,” after “matters”.

## 21 Advice relating to the disposition of charity land

In section 119 of the Charities Act 2011 (requirements for dispositions other than certain leases) – 40

- (a) in subsection (1)(a), for “qualified surveyor” substitute “designated adviser”;
- (b) in subsection (1)(c), for “surveyor’s” substitute “adviser’s”;
- (c) in subsection (3), for “qualified surveyor” substitute “designated adviser”.

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## 22 Advice etc from charity trustees, officers and employees

- (1) The Charities Act 2011 is amended as follows.
- (2) After section 128 insert –

*“Advice etc from charity trustees, officers and employees*

### 128A Advice etc from charity trustees, officers and employees

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- (1) Subsection (2) applies to –
  - (a) a report by a designated adviser for the purposes of section 119(1)(a),
  - (b) advice on a proposed disposition for the purposes of section 120(2)(a),
  - (c) proper advice in connection with a mortgage of land for the purposes of section 124(2), and
  - (d) proper advice in connection with a mortgage of land for the purposes of section 124(7).
- (2) For the purposes of the provisions mentioned in subsection (1), it does not matter if the report or the advice (as the case may be) is provided –
  - (a) by a charity trustee or an officer or employee of the charity or of the charity trustees, or
  - (b) in the course of a person’s employment as an officer or an employee of the charity or of the charity trustees.”
- (3) In section 124 (restrictions on mortgages), in subsection (8), omit from “and such advice” to the end.

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## 23 Residential tenancies granted to employees

In section 118 of the Charities Act 2011 (meaning of “connected person” in section 117(2)), after subsection (2) insert –

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- “(2A) A person who is an employee of the charity does not fall within subsection (2)(d) if the disposition in question is the grant of a tenancy –
- (a) for a fixed term of one year or less or which is a periodic tenancy and the period is one year or less, and
  - (b) which confers the right to occupy a dwelling as a home.”

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## 24 Information to be included in certain instruments

- (1) The Charities Act 2011 is amended as follows.
- (2) In section 122 (instruments concerning dispositions of land: required statements, etc) –

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- (a) for subsection (2) substitute –
- “(2) An instrument to which this subsection applies must –
- (a) state that the land is held by or in trust for a charity,
  - (b) state whether the charity is an exempt charity,
  - (c) if the charity is not an exempt charity, state whether the disposition is one falling within section 117(3)(a), (aa), (c) or (d), and 5
  - (d) if the charity is not an exempt charity and the disposition is not one falling within section 117(3)(a), (aa), (c) or (d), include the statement required by subsection (2A). 10
- (2A) The statement is –
- (a) in a case where section 117(1) applies to the disposition to which the instrument relates, a statement that the disposition has been sanctioned by an order of the court or of the Charity Commission, or 15
  - (b) in a case where section 117(2) applies to the disposition to which the instrument relates, a statement that there is power under the trusts of the charity to effect the disposition and that sections 117 to 120 have been complied with.”; 20
- (b) omit subsection (3);
- (c) for subsection (4) substitute –
- “(4) Where subsection (2)(d) has been complied with in relation to a contract for the disposition of land it is conclusively presumed, for the purposes of enforcing the contract, that the statement is true. 25
- (4A) Where subsection (2)(d) has been complied with in relation to an instrument effecting the disposition of land it is conclusively presumed, in favour of a person who (whether under the disposition or afterwards) acquires an interest in the land for money or money’s worth, that the statement is true.”; 30
- (d) for subsections (5) and (6) substitute –
- “(5) Where subsection (2)(d) applies in relation to a contract for the disposition of land but the statement required by subsection (2A) has not been included in it, then in favour of a person who has entered into the contract in good faith the contract is enforceable as if – 35
- (a) the disposition to which the contract relates had been sanctioned by an order of the court or of the Charity Commission, or 40
  - (b) there is power under the trusts of the charity to effect such a disposition and sections 117 to 120 have been complied with.
- (5A) Where subsection (2)(d) applies in relation to an instrument effecting the disposition of land but the statement required by subsection (2A) has not been included in it, then in favour of a person who (whether under the disposition or afterwards) in 45

- good faith acquires an interest in the land for money or money's worth, the disposition is valid even if—
- (a) the disposition has not been sanctioned by an order of the court or of the Charity Commission, or
  - (b) there is no power under the trusts of the charity to effect the disposition or sections 117 to 120 have not been complied with in relation to it (or both).” 5
- (3) In section 125 (mortgages: required statements, etc) —
- (a) for subsection (1) substitute —
    - “(1) Any mortgage of land held by or in trust for a charity must— 10
      - (a) state that the land is held by or in trust for a charity,
      - (b) state whether the charity is an exempt charity and whether the mortgage is one falling within section 124(9), and
      - (c) if the charity is not an exempt charity and the mortgage is not one falling within section 124(9), include the statement required by subsection (1A). 15
    - (1A) The statement is —
      - (a) in a case where section 124(1) applies, a statement that the mortgage has been sanctioned by an order of the court or of the Charity Commission, or 20
      - (b) in a case where section 124(2) applies, a statement that there is power under the trusts of the charity to grant the mortgage and the requirements of section 124(2) have been complied with.”; 25
  - (b) omit subsection (2);
  - (c) in subsection (3) —
    - (i) for “subsection (2)” substitute “subsection (1)(c)”;
    - (ii) for the words from “facts” to the end substitute “statement is true”; 30
  - (d) for subsections (4) and (5) substitute —
    - “(5) Where subsection (1)(c) applies in relation to a mortgage of land but the statement required by subsection (1A) has not been included in it, then in favour of a person who (whether under the mortgage or afterwards) in good faith acquires an interest in the land for money or money's worth, the mortgage is valid even if— 35
      - (a) the mortgage has not been sanctioned by an order of the court or of the Charity Commission, or
      - (b) there is no power under the trusts of the charity to grant the mortgage or section 124 has not been complied with in relation to it (or both).” 40

#### *Connected persons*

### 25 “Connected person”: wholly-owned companies etc

- (1) The Charities Act 2011 is amended as follows. 45
- (2) In section 118 (meaning of “connected person” in section 117(2)), after

subsection (2A) (as inserted by section 23), insert –

“(2B) A person does not fall within subsection (2)(g) or (h) if the person is a body corporate which is wholly-owned by the charity.

(2C) A body corporate is wholly-owned by a charity if –

(a) it is a body corporate of which no person is a member other than – 5

(i) the charity,

(ii) a person who is a charity trustee acting on behalf of the charity,

(iii) a person who is a trustee for the charity acting on behalf of the charity, or 10

(iv) a nominee of any person falling within any of subparagraphs (i) to (iii), or

(b) it is a wholly-owned subsidiary (within the meaning of section 1159 of the Companies Act 2006) of a body corporate within paragraph (a).” 15

(3) After section 128A (as inserted by section 22) insert –

*“Notification of certain disposals*

**128B Notification of disposal to wholly-owned company etc**

(1) This section applies where – 20

(a) land held by or in trust for a charity has been conveyed, transferred, leased or otherwise disposed of to –

(i) a body corporate which is wholly-owned by the charity (within the meaning of section 118(2C)), or

(ii) a trustee for, or a nominee of, such a body corporate, and 25

(b) in reliance on section 117(2) and section 118(2B) no order of the court or of the Commission was obtained in respect of the disposition.

(2) Within 14 days of the disposal the charity trustees must notify the Commission that the disposal has taken place. 30

(3) A notification under subsection (2) must include –

(a) a copy of the report of the designated adviser obtained for the purposes of section 119(1)(a), or

(b) a copy of the advice obtained for the purposes of section 120(2)(a) (or, if the advice obtained for the purposes of that section was not provided to the charity trustees in writing, a summary of the contents of the advice).” 35

*UCEA 1925*

**26 Universities and College Estates Act 1925**

(1) The Universities and College Estates Act 1925 is amended in accordance with subsections (2) to (6). 40

- (2) After section 1 insert –

*“General power over land*

**1A General power over land**

- (1) A university or college has in relation to land belonging to the university or college all the powers of an absolute owner. 5
- (2) The power conferred by subsection (1) is subject to –
- (a) any restriction, condition or limitation imposed by, or arising under, any enactment,
  - (b) any rule of law or equity, or
  - (c) the statutes regulating the university or college.” 10
- (3) Omit sections 2 to 39 and Schedule 1.
- (4) In section 40 (power to transfer to university or college), omit “with the consent of the Minister”.
- (5) In section 42 (saving of existing powers) omit from “: Provided that” to the end.
- (6) In section 43 (definitions) – 15
- (a) in the opening words, omit from “unless” to “say”;
  - (b) omit sub-paragraphs (i) and (ii), (viii) and (x).
- (7) Schedule 2 (which contains consequential amendments) has effect.

**PART 3**

CHARITY NAMES 20

**27 Working names etc**

- (1) The Charities Act 2011 is amended as follows.
- (2) In section 42 (power to require name to be changed) –
- (a) in the heading, after “name” insert “or working name”;
  - (b) for subsection (1) substitute – 25
    - “(1) If one or more of the conditions in subsection (2) are met in relation to a charity, the Commission may give a direction –
    - (a) requiring the name of the charity to be changed to a name determined by the charity trustees with the approval of the Commission, or 30
    - (b) requiring that a working name of the charity no longer be used as its working name.”;
  - (c) in subsection (2) –
    - (i) for paragraph (a) and the words before it substitute –
      - “(2) The conditions are – 35
      - (a) that the name or working name is the same as, or in the opinion of the Commission too like, the name or a working name of another charity.”;
    - (ii) in paragraph (b), for “the name of the charity” substitute “that the name or working name”; 40



- (iii) in paragraph (c), for “the name of the charity” substitute “that the name or working name”, and for “its name” substitute “the name or working name”;
- (iv) in paragraph (d), for “the name of the charity” substitute “that the name or working name”; 5
- (v) in paragraph (e), for “the name of the charity” substitute “that the name or working name”.
- (d) omit subsection (3);
- (e) for subsection (4) substitute –
  - “(4) In this Act, any reference to a working name of a charity is a reference to a name that is not the name of the charity but under which activities of the charity are carried out.” 10
- (3) In section 43 (duty of charity trustees on receiving direction under section 42), in subsection (1), for the words from “it regardless” to the end substitute “it –
  - (a) within such period as is specified in the direction, and 15
  - (b) regardless of anything in the trusts of the charity.”

## 28 Power to delay registration of unsuitably named charity

After section 45 of the Charities Act 2011 insert –

### “45A Power to delay registration following s. 42 direction

- (1) The Commission may delay the registration of a charity if the Commission has given a direction under section 42 (“the section 42 direction”) requiring the name of the charity to be changed. 20
- (2) A delay under subsection (1) may last until the first to occur of –
  - (a) the charity trustees notifying the Commission of the charity’s new name and the date of the name change, or 25
  - (b) the expiry of the maximum postponement period.
- (3) The “maximum postponement period” is the period of 60 days beginning at the end of the period specified in the section 42 direction for giving effect to the direction.
- (4) If any relevant proceedings are commenced, the period of 60 days mentioned in subsection (3) stops running while the proceedings are ongoing. 30
- (5) Each of the following are “relevant proceedings” –
  - (a) proceedings on an appeal brought to the Tribunal under section 319 against the section 42 direction or against any steps taken by the Commission with a view to securing compliance with the section 42 direction; 35
  - (b) proceedings on an application made to the Tribunal under section 321 for the review of the Commission’s decision to institute an inquiry under section 46 in respect of matters connected with the section 42 direction; 40
  - (c) proceedings on an application for judicial review of the Commission’s decision to give the section 42 direction or to take any steps with a view to securing compliance with the section 42 direction; 45

- (d) proceedings on an application under section 336 in respect of disobedience to the section 42 direction.
- (6) Relevant proceedings are commenced when an application, claim form or other process is made or issued for the purpose of commencing the proceedings. 5
- (7) Relevant proceedings are ongoing until—
  - (a) the proceedings (including any proceedings on appeal or further appeal) have been concluded, and
  - (b) any period during which an appeal (or further appeal) may ordinarily be made has passed.” 10

## 29 Power to delay entry of unsuitable name in register

After section 45A of the Charities Act 2011 insert—

### “45B Power to delay entry of name in register following a s. 42 direction

- (1) If the charity trustees of a charity notify the Commission under section 35(3) of a change of name of the charity, the Commission may delay changing the charity’s name in the register if the Commission has given a direction under section 42 (“the section 42 direction”) requiring the new name to be changed. 15
- (2) A delay under subsection (1) may last until the first to occur of—
  - (a) the charity trustees notifying the Commission of the charity’s further new name and the date of the further name change, or 20
  - (b) the expiry of the maximum postponement period.
- (3) The “maximum postponement period” is the period of 60 days beginning at the end of the period specified in the section 42 direction for giving effect to the direction. 25
- (4) If any relevant proceedings are commenced, the period of 60 days mentioned in subsection (3) stops running while the proceedings are ongoing.
- (5) Each of the following are “relevant proceedings”—
  - (a) proceedings on an appeal brought to the Tribunal under section 319 against the section 42 direction or against any steps taken by the Commission with a view to securing compliance with the section 42 direction; 30
  - (b) proceedings on an application made to the Tribunal under section 321 for the review of the Commission’s decision to institute an inquiry under section 46 in respect of matters connected with the section 42 direction; 35
  - (c) proceedings on an application for judicial review of the Commission’s decision to give the section 42 direction or to take any steps with a view to securing compliance with the section 42 direction; 40
  - (d) proceedings on an application under section 336 in respect of disobedience to the section 42 direction.
- (6) Relevant proceedings are commenced when an application, claim form or other process is made or issued for the purpose of commencing the proceedings. 45

- (7) Relevant proceedings are ongoing until –
- (a) the proceedings (including any proceedings on appeal or further appeal) have been concluded, and
  - (b) any period during which an appeal (or further appeal) may ordinarily be made has passed.”

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### 30 Power to direct change of name of exempt charity

In Schedule 9 to the Charities Act 2011 (transitory modifications), omit paragraph 10 and the italic heading before it.

## PART 4

### CHARITY TRUSTEES

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### 31 Powers relating to appointments of trustees

After section 184A of the Charities Act 2011 insert –

#### *“Invalid appointment of charity trustee*

#### **184B Power to confirm trustee appointments etc**

- (1) Subsection (2) applies if –
- (a) a person acts, or intends to act, as a charity trustee in relation to a charity, but
  - (b) there is not, or might not be, a valid appointment or election of that person to a qualifying position in relation to that charity.
- (2) The Commission may, with the consent of the person concerned, by order provide that for the purposes of anything done (or not done) on or after the date of the order –
- (a) any defect in the person’s appointment or election to a qualifying position (including any absence of appointment or election) is to be ignored in relation to the charity, and
  - (b) accordingly, there is to be treated as being a valid appointment or election to a qualifying position in respect of the person.
- (3) A position is a “qualifying position” in relation to a charity if, as a result of a person holding that position, the person is a charity trustee of the charity.
- (4) A position need not be a position in the charity to be a qualifying position.
- (5) An order under subsection (2) may include –
- (a) provision with respect to the vesting in or transfer of property that the Commission could make on the removal or appointment of a charity trustee by it under section 69 (Commission’s concurrent jurisdiction with High Court for certain purposes);
  - (b) provision that an act of a person who is the subject of the order is valid notwithstanding that there was not at the time the act was carried out a valid appointment or election to a qualifying position in respect of that person.

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- (6) An order containing provision made by virtue of subsection (5)(a) has the same effect as an order made under section 69.”

### 32 Remuneration of charity trustees etc providing goods or services to charity

In section 185 of the Charities Act 2011 (remuneration of charity trustees etc providing services to charity) –

- (a) in the heading, before “services” insert “goods or”; 5
- (b) in subsection (1), in the words before paragraph (a), before “services” insert “goods or”;
- (c) in subsection (2) –
  - (i) in paragraphs (a) and (b) of Condition A, before “services” insert “goods or”; 10
  - (ii) in condition B, before “services” insert “goods or”;
- (d) for subsection (3) substitute –
  - “(3) This section does not apply to any remuneration for services provided by a person in the person’s capacity as a charity trustee or trustee for a charity or under a contract of employment. 15
  - (3A) Any entitlement to receive remuneration under subsection (2) is in addition to and does not affect any entitlement to receive the remuneration by virtue of – 20
    - (a) any provision contained in the trusts of the charity;
    - (b) any order of the court or the Commission;
    - (c) any other statutory provision contained in or having effect under any Act.”

### 33 Remuneration etc of charity trustees etc 25

After section 186 of the Charities Act 2011 insert –

#### “186A Remuneration etc for work already carried out

- (1) This section applies to a person who –
  - (a) has carried out work for or on behalf of a charity, and
  - (b) is a charity trustee or trustee for the charity (or was one when the work was carried out). 30
- (2) If the condition in subsection (3) is met, the Commission may by order –
  - (a) require the charity trustees of the charity to pay the person such remuneration for the work as must be specified in the order; 35
  - (b) authorise, to such extent as must be specified in the order, any benefit already received in connection with the work to be retained.
- (3) The condition in this subsection is that the Commission considers that it would be inequitable for the person not to be paid the remuneration or not to retain the benefit. 40
- (4) In determining whether to make an order under this section the Commission must in particular have regard to –

- (a) whether, if the person had not carried out the work, the charity would have employed someone else to do so,
- (b) the level of skill with which the work was carried out,
- (c) any express provision in the trusts of the charity prohibiting the person from receiving the remuneration or retaining the benefit, and 5
- (d) whether remunerating the person or allowing the person to retain the benefit would encourage breaches of trust or breaches of duty by persons in their capacity as charity trustees or trustees for charities.” 10

### 34 Trustee of charitable trust: status as trust corporation

- (1) After section 334 of the Charities Act 2011 insert –

*“Trustee of charitable trust: status as trust corporation*

#### 334A Status of certain trustees of charitable trusts

- (1) For the purposes of the provisions listed in subsection (2), “trust corporation” includes a trustee of or for a charitable trust if that trustee is a body corporate and itself a charity. 15
- (2) The provisions are –
- (a) section 117(1)(xxx) of the Settled Land Act 1925,
  - (b) paragraph (18) of section 68(1) of the Trustee Act 1925, 20
  - (c) section 205(1)(xxviii) of the Law of Property Act 1925,
  - (d) section 55(1)(xxvi) of the Administration of Estates Act 1925, and
  - (e) section 128 of the Senior Courts Act 1981.”
- (2) The amendment made by subsection (1) has effect in relation to any trustee, even if the trustee was the trustee of or for the charitable trust before the amendment comes into force. 25

## PART 5

### CHARITY MERGERS

*Gifts to merged charity* 30

### 35 Gifts to merged charity

- (1) The Charities Act 2011 is amended as follows.
- (2) In section 239 (effect of registration of CIO), for subsection (3) substitute –
- “(3) Subsection (4) applies to a gift if –
- (a) the gift would have taken effect as a gift to one of the old CIOs if it had not been dissolved, and 35
  - (b) the date on which the gift would have taken effect is a date on or after the date of the registration of the new CIO.
- (4) The gift takes effect as a gift to the new CIO.”

- (3) In section 244 (effect of confirmation of resolution to transfer property etc to another CIO), for subsection (2) substitute –
- “(2) Subsection (3) applies to a gift if –
- (a) the gift would have taken effect as a gift to the transferor CIO if it had not been dissolved, and 5
- (b) the date on which the gift would have taken effect is a date on or after the date on which the resolution is confirmed (or treated as confirmed).
- (3) The gift takes effect as a gift to the transferee CIO.”
- (4) In section 311 (effect of registering charity merger on gifts to transferor), for subsection (2) substitute – 10
- “(2) Subsection (2A) applies to a gift, other than an excluded gift, if –
- (a) the gift would have taken effect as a gift to the transferor if the transferor had been in existence, and
- (b) the date on which the gift would have taken effect is a date on or after the date of the registration of the merger. 15
- (2A) The gift takes effect as a gift to the transferee.”
- (5) The amendments made by this section have effect in relation to all gifts made on or after the date this section comes into force; and it does not matter if the will or other document, agreement, transaction or other means which gives rise to the gift was executed or entered into before that date. 20

#### *Vesting declarations*

### **36 Vesting declarations: exclusions**

- In section 310(3) of the Charities Act 2011 (exclusion of certain property from automatic vesting following a vesting declaration) – 25
- (a) omit paragraph (a), and
- (b) for paragraph (b) (but not the “or” following it) substitute –
- “(b) any land held by the transferor under a lease or agreement if, had the transferor assigned its interest in the land on the specified date to the transferee, that assignment would have given rise to – 30
- (i) an actionable breach of covenant or condition against alienation, or
- (ii) a forfeiture.”.

### **37 Vesting permanent endowment following a merger** 35

- (1) In section 306 of the Charities Act 2011 (meaning of “relevant charity merger”), in subsection (2) –
- (a) in paragraph (a), omit “a”;
- (b) omit paragraph (b) and the “and” before it.
- (2) Omit regulation 61 of the Charitable Incorporated Organisation (General) Regulations 2012 (S.I. 2012/3012). 40

## PART 6

### LEGAL PROCEEDINGS

#### 38 Consent for the taking of charity proceedings

- (1) The Charities Act 2011 is amended as follows.
- (2) In section 115(5) (proceedings by persons other than the Charity Commission: exceptions to requirement for Commission authorisation), for the words from “if” to the end substitute “if –
  - (a) a condition in subsection (5A) is met, and
  - (b) leave to take the proceedings is obtained from one of the judges of the High Court attached to the Chancery Division.” 10
- (3) After section 115(5) insert –

“(5A) The conditions referred to in subsection (5)(a) are –
  - (a) that the Commission has refused an application for the order;
  - (b) that an application to the Commission for the order would, or would appear to, give rise to a conflict of interest affecting the Commission.” 15

#### 39 Costs incurred in relation to Tribunal proceedings etc

After section 324 of the Charities Act 2011 insert –

##### “324A Power to authorise costs to be incurred in relation to proceedings

- (1) The Tribunal may make an authorised costs order on the application of a charity or charity trustees of a charity. 20
- (2) An authorised costs order is an order –
  - (a) made in respect of proceedings brought, or proposed to be brought, before the Tribunal or on appeal from it, and
  - (b) authorising payment out of the funds of the charity of costs falling within subsection (3). 25
- (3) Those costs are costs incurred, or to be incurred, in connection with the proceedings –
  - (a) by the charity,
  - (b) by charity trustees, or 30
  - (c) by any other person, so far as the charity or its charity trustees are ordered by the Tribunal or the court hearing the appeal to bear them.”

#### 40 References to the Tribunal

- (1) In section 325 of the Charities Act 2011 (references by the Charity Commission to the Tribunal), for subsection (2) substitute –
  - “(2) The Commission must give the Attorney General notice of its intention to make a reference under subsection (1). 35

- (2A) The reference may not be made until at least 28 days after notice is given to the Attorney General in accordance with subsection (2), unless the Attorney General agrees that it may be made earlier.”
- (2) In section 326 of the Charities Act 2011 (references by the Attorney General to the Tribunal), after subsection (1) insert – 5
- “(1A) The Attorney General must give the Commission notice of its intention to make a reference under subsection (1).
- (1B) The reference may not be made until at least 28 days after notice is given to the Commission in accordance with subsection (1A), unless the Commission agrees that it may be made earlier.” 10

## PART 7

### GENERAL

#### 41 Public notice of Commission consent

- (1) Section 337 of the Charities Act 2011 (other provisions as to orders of Commission) is amended as follows. 15
- (2) In subsection (3) –
- (a) in the opening words, after “order” insert “or gives written consent”;
  - (b) in paragraph (a), after “order” insert “or consent”;
  - (c) in paragraph (b)(i), after “made” insert “or the consent is given”;
  - (d) in paragraph (b)(ii), after “order” insert “or consent”. 20
- (3) In the heading for “orders” substitute “orders etc”.

#### 42 “Connected person”: illegitimate children

In section 350(1) of the Charities Act 2011 (connected person: meaning of “child”) omit “and an illegitimate child”.

#### 43 “Connected person”: power to amend 25

- (1) After section 352 of the Charities Act 2011 insert –
- “352A Power to amend definition of “connected person”**
- The Secretary of State may by regulations amend this Act to alter what is a “connected person” for the purposes of any provision of this Act.”
- (2) In section 348 of that Act (regulations subject to affirmative procedure etc) – 30
- (a) in subsection (1), after paragraph (c) insert –
    - “(d) regulations under section 352A (power to amend definition of “connected person”).”;
  - (b) in subsection (2), for “or (c)” substitute “, (c) or (d)”.

#### 44 Minor and consequential provision 35

Schedule 3 (which contains minor and consequential provision) has effect.



**45 Extent, commencement and short title**

- (1) This Act extends to England and Wales only, subject to subsection (2).
- (2) An amendment made by –
  - (a) section 26;
  - (b) Schedule 1 or 2; 5
  - (c) paragraph 12 or 43 of Schedule 3,has the same extent as the enactment or provision to which it relates.
- (3) This section comes into force on the day on which this Act is passed.
- (4) The other provisions of this Act come into force on such day as the Secretary of State may by regulations made by statutory instrument appoint and different days may be appointed for different purposes. 10
- (5) Regulations under subsection (4) may make consequential, transitional or saving provision.
- (6) This Act may be cited as the Charities Act 2017.

## SCHEDULES

### SCHEDULE 1

Section 19

#### REPEAL OF SECTION 121 OF THE CHARITIES ACT 2011: CONSEQUENTIAL AMENDMENTS

##### *Literary and Scientific Institutions Act 1854*

- |   |  |   |
|---|--|---|
| 1 | In section 6 of the Literary and Scientific Institutions Act 1854 (corporation, justices, trustees etc to convey land), for “and 119 to 121” substitute “, 119 and 120”. | 5 |
|---|--|---|

##### *Places of Worship Sites Amendment Act 1882*

- |   |   |    |
|---|---|----|
| 2 | In section 1(d) of the Places of Worship Sites Amendment Act 1882 (conveyance of lands by corporations and other public bodies), for “and 119 to 121” substitute “, 119 and 120”. | 10 |
|---|---|----|

##### *Technical and Industrial Institutions Act 1892*

- |   |   |  |
|---|---|--|
| 3 | In section 9(1) of the Technical and Industrial Institutions Act 1892 (site may be sold or exchanged), for “and 119 to 121” substitute “, 119 and 120”. |  |
|---|---|--|

##### *Open Spaces Act 1906*

- |   |   |    |
|---|---|----|
| 4 | In section 4 of the Open Spaces Act 1906 (transfer by charity trustees of open space to local authority), in subsection (1A)(b), for “and 119 to 121” substitute “, 119 and 120”. | 15 |
|---|---|----|

##### *New Parishes Measure 1943 (No 1)*

- |   |   |    |
|---|---|----|
| 5 | In section 14 of the New Parishes Measure 1943 (power of corporations, etc, to give or grant land for sites of churches, etc), in subsection (1)(b)(ii), for “and 119 to 121” substitute “, 119 and 120”. | 20 |
|---|---|----|

##### *London County Council (General Powers) Act 1947 (c. xlvi)*

- |   |  |    |
|---|--|----|
| 6 | In section 6 of the London County Council (General Powers) Act 1947 (saving for open spaces licensing and certain trusts), in subsection (3), for “and 119 to 121” substitute “, 119 and 120”. | 25 |
|---|--|----|

##### *London County Council (General Powers) Act 1955 (c. xxix)*

- |   |  |    |
|---|--|----|
| 7 | In section 34 of the London County Council (General Powers) Act 1955 (extension of powers of Council as to erection of buildings), in subsection (3), for “and 119 to 121” substitute “, 119 and 120”. | 30 |
|---|--|----|

*Leasehold Reform Act 1967*

- 8 In section 23 of the Leasehold Reform Act 1967 (agreements excluding or modifying rights of tenant), in subsection (4), for “to 121” substitute “to 120”.

*Sharing of Church Buildings Act 1969*

- 9 In section 8 of the Sharing of Church Buildings Act 1969 (application of Charities Act), in subsection (3), for “to 121” substitute “to 120”. 5

*Local Government Act 1972*

- 10 In section 131 of the Local Government Act 1972 (savings), in subsection (3), for “to 121” substitute “to 120”.

*Theatres Trust Act 1976*

10

- 11 In section 2 of the Theatres Trust Act 1976 (objects of Trust and powers of trustees), in subsection (2)(d), for “to 121” substitute “to 120”.

*Endowments and Glebe Measure 1976 (No 4)*

- 12 In section 11 of the Endowments and Glebe Measure 1976 (extinguishment of certain trusts), in subsection (2), for “and 119 to 121” substitute “, 119 and 120”. 15

*Housing Associations Act 1985*

- 13 (1) The Housing Associations Act 1985 is amended as follows.  
(2) In section 10 (dispositions by unregistered housing associations excepted from control), in subsection (1), for “to 121” substitute “to 120”. 20  
(3) In section 35 (power of housing trusts to transfer housing), in subsection (2)(c), for “to 121” substitute “to 120”.

*Leasehold Reform, Housing and Urban Development Act 1993*

- 14 In section 93 of the Leasehold Reform, Housing and Urban Development Act 1993 (agreements excluding or modifying rights of tenant), in subsection (6)(a), for “to 121” substitute “to 120”. 25

*Cathedrals Measure 1999 (No 1)*

- 15 In section 15 of the Cathedrals Measure 1999 (acquisition and disposal of land), in subsection (1), in paragraph (iii) of the proviso, for “to 121” substitute “to 120”. 30

*Charities Act 2011*

- 16 (1) The Charities Act 2011 is amended as follows.  
(2) In section 117 (restrictions on dispositions of land: general), in subsections (1), (3) (in both places) and (4), for “to 121” substitute “and 120”.

- (3) In section 122 (instruments concerning dispositions of land), in subsection (8)(c), for “to 121” substitute “to 120”.
- (4) In section 123 (land registration), in subsection (2), for “to 121” substitute “to 120”.
- (5) In section 126 (mortgages), in subsections (2)(b) and (3), for “to 121” substitute “to 120”. 5

## SCHEDULE 2

Section 26

## AMENDMENTS OF UNIVERSITIES AND COLLEGE ESTATES ACT 1925: CONSEQUENTIAL AMENDMENTS

*Landlord and Tenant Act 1927* 10

- 1 In section 13 of the Landlord and Tenant Act 1927 (power to apply and raise capital money), in subsection (1) omit “, or under the University and College Estates Act 1925,”.

*Landlord and Tenant (War Damage) Act 1939*

- 2 In section 3 of the Landlord and Tenant (War Damage) Act 1939 (raising money for making good war damage on settled land, etc) – 15
- (a) omit paragraph (d) and the “or” preceding it, and
- (b) omit from “, or Part I of the First Schedule” to the end.

*Universities and Colleges (Trusts) Act 1943*

- 3 (1) Section 2 of the Universities and Colleges (Trusts) Act 1943 (schemes for administering university and college trusts) is amended as follows. 20
- (2) Omit subsection (2).
- (3) In subsection (3) –
- (a) omit from “, subject to the modification that” to “as aforesaid;”, and
- (b) omit “, subject to the modification aforesaid”. 25
- (4) Omit subsection (5).

*Coast Protection Act 1949*

- 4 In section 11 of the Coast Protection Act 1949 (incidence of coast protection charges, etc), in subsection (2)(a) – 30
- (a) omit “and by section twenty-six of the Universities and College Estates Act 1925”, and
- (b) omit “and by section thirty of the Universities and College Estates Act 1925”.

*Landlord and Tenant Act 1954*

- 5 In paragraph 6 of Schedule 2 to the Landlord and Tenant Act 1954 (provisions as to repair where tenant retains possession) – 35

- (a) omit “and by section twenty-six of the Universities and College Estates Act 1925”, and
- (b) omit “and by section thirty of the Universities and College Estates Act 1925”.

*Universities and College Estates Act 1964* 5

- 6 (1) The Universities and Colleges Estates Act 1964 is amended as follows.
- (2) Omit sections 2 and 3.
  - (3) Omit Schedules 1 and 2.

*Forestry Act 1967*

- 7 In Schedule 2 to the Forestry Act 1967 (forestry dedication etc), omit paragraph 2. 10

*Leasehold Reform Act 1967*

- 8 (1) The Leasehold Reform Act 1967 is amended as follows.
- (2) In section 24(1) (application of price or compensation received by landlord, etc), omit paragraph (b) and the “and” preceding it. 15
  - (3) In Schedule 2 (supplemental), omit paragraph 9(2).

*Mines and Quarries (Tips) Act 1969*

- 9 In section 32 of the Mines and Quarries (Tips) Act 1969 (raising of money in special cases), in subsection (2) –
- (a) in paragraph (a), omit “and by section 26 of the Universities and College Estates Act 1925”, and 20
  - (b) in paragraph (b), omit “and by section 30 of the Universities and College Estates Act 1925”.

*Agriculture Act 1970*

- 10 In section 61 of the Agriculture Act 1970 (special classes of land), in subsection (6), omit “, the Universities and College Estates Act 1925”. 25

*Agriculture (Miscellaneous Provisions) Act 1976*

- 11 In Schedule 3 to the Agriculture (Miscellaneous Provisions) Act 1976 (enactments to which power to amend applies), omit the entry relating to the Universities and College Estates Act 1925. 30

*Universities and Colleges Estates Act 1925 (Amendment) Regulations 1978 (S.I. 1978/443)*

- 12 The Universities and Colleges Estates Act 1925 (Amendment) Regulations 1978 (S.I. 1978/443) are revoked.

*Highways Act 1980*

- 13 In section 87 of the Highways Act 1980 (agreements for use of land for cattle-grids or by-passes), omit subsection (5). 35

*Agricultural Holdings Act 1986*

- 14 In section 89 of the Agricultural Holdings Act 1986 (power of limited owners to apply capital for improvements), omit subsection (2).

*Town and Country Planning Act 1990*

- 15 (1) Section 328 of the Town and Country Planning Act 1990 (settled land and land of universities and colleges) is amended as follows. 5
- (2) Omit subsection (1)(b) and the “and” preceding it.
- (3) Omit subsection (2)(b) and the “and” preceding it.
- (4) In the heading omit “and land of universities and colleges”.

*Solicitors’ Recognised Bodies Order 1991 (S.I. 1991/2684)* 10

- 16 In Schedule 1 to the Solicitors’ Recognised Bodies Order 1991 (S.I. 1991/2684) (statutes which apply to recognised bodies) omit the entry relating to the Universities and College Estates Act 1925.

*Leasehold Reform, Housing and Urban Development Act 1993*

- 17 (1) The Leasehold Reform, Housing and Urban Development Act 1993 is amended as follows. 15
- (2) In Schedule 2 (special categories of landlords), omit paragraph 7 and the italic heading before it.
- (3) In Schedule 14 (supplementary provision), omit paragraph 10.

*Agricultural Tenancies Act 1995* 20

- 18 In section 33 of the Agricultural Tenancies Act 1995 (power to apply and raise capital money), in subsection (1), omit “or section 26 of the Universities and College Estates Act 1925”.

*Housing Grants, Construction and Regeneration Act 1996*

- 19 In section 55 of the Housing Grants, Construction and Regeneration Act 1996 (cessation of conditions on repayment of grant, etc), omit subsection (4)(c) and the “and” preceding it. 25

*Cathedrals Measure 1999 (No 1)*

- 20 In section 36 of the Cathedrals Measure 1999 (construction of references to dean and chapter, etc), in subsection (2), omit the entry relating to the Universities and College Estates Act 1925. 30

*Trustee Act 2000*

- 21 In Schedule 2 to the Trustee Act 2000 (consequential amendments), omit paragraph 29 and the italic heading before it.

*Constitutional Reform Act 2005*

- 22 In paragraph 4(3) of Schedule 11 to the Constitutional Reform Act 2005 (miscellaneous amendments: Supreme Court of England and Wales), omit “the Universities and College Estates Act 1925 (c 24)”.

## SCHEDULE 3

Section 44

5

## MINOR AND CONSEQUENTIAL AMENDMENTS

## PART 1

## AMENDMENTS RELATING TO PART 1

- 1 The Charities Act 2011 is amended in accordance with paragraphs 2 to 11 and 13 to 26. 10

*Amendment relating to section 2 of this Act*

- 2 In the table in Schedule 6 (appeals and applications to tribunal), for the entry relating to the decision of the Commission under section 227 to refuse to register an amendment to the constitution of a CIO substitute –

“Decision of the Commission under section 226 to give, or withhold, consent under section 226 in relation to an amendment of the constitution of a CIO.	The persons are – (a) the CIO, (b) the charity trustees of the CIO, and (c) any other person who is or may be affected by the decision.	Power to quash the decision and (if appropriate) remit the matter to the Commission.”	15
			20

*Amendments relating to section 3 of this Act*

- 3 In section 285 (power to alter sums specified in Part 13) –  
(a) for the words from “any provision” to the end substitute “section 282(1) (market value of fund for purposes of resolution to spend larger fund”;  
(b) omit subsection (2). 25
- 4 In section 328 (suspension of time limits while reference is in progress), omit subsection (3).
- 5 In section 350 (connected person: child, spouse and civil partner) – 30  
(a) in subsection (1), for “and 249(2)(a)” substitute “, 249(2)(a) and 280B(4)(a)”;  
(b) in subsection (2), for “and 249(2)(b)” substitute “, 249(2)(b) and 280B(4)(b)”.

6	In section 351 (connected person: controlled institution), for “and 249(2)(d)” substitute “, 249(2)(d) and 280B(4)(d)”.	
7	In section 352 (connected person: substantial interest in body corporate), in subsection (1), for “and 249(2)(e)” substitute “, 249(2)(e) and 280B(4)(e)”.	
8	In the table in Schedule 6 (appeals and applications to tribunal) omit –	5
	(a) the entry relating to the decision of the Commission to notify charity trustees under section 271(1).	
	(b) the entry relating to the decision of the Commission to notify charity trustees under section 278(1).	
9	In Schedule 9 (transitory modifications), in the table in paragraph 26(3), omit the entry relating to “section 69O”.	10
10	In Schedule 11 (index of defined expressions) –	
	(a) in the entry relating to “child” for “and 249(2)(a)” substitute “, 249(2)(a) and 280B(4)(a)”;	
	(b) in the entry relating to “civil partner” for “and 249(2)(b)” substitute “, 249(2)(b) and 280B(4)(b)”;	15
	(c) in the entry relating to “control of institution” for “and 249(2)(d)” substitute “, 249(2)(d) and 280B(4)(d)”;	
	(d) in the entry relating to “substantial interest in a body corporate” for “and 249(2)(e)” substitute “, 249(2)(e) and 280B(4)(e)”;	20
	(e) omit the entry relating to “transfer of property (in sections 268 to 274)”.	

*Amendment relating to section 5 of this Act*

11	In section 349 (orders subject to affirmative procedure), in subsection (1), omit paragraph (b).	25
12	In section 5 of the Coal Industry Act 1987 (coal industry trusts), in subsection (8), for “73(1) to (6)” substitute “73(1), (2) and (5)”.	

*Amendments relating to section 6 of this Act*

13	In section 66 (unknown and disclaiming donors: supplementary) –	
	(a) for the heading, substitute “Section 63A: supplementary”;	30
	(b) in subsection (1), for “sections 63 and 65” substitute “section 63A”;	
	(c) after subsection (1) insert –	
	“(1A) Where property is applied cy-près by virtue of section 63A, all the donor’s interest in it is treated as having been relinquished when the gift was made.”;	35
	(d) in subsection (2), for “sections 63 to 65” substitute “section 63A”;	
	(e) omit subsections (4) to (6).	
14	In Schedule 8 (transitionals and savings), omit paragraph 17 and the italic heading before it.	
15	In Schedule 11 (index of defined expressions) –	40
	(a) in the entry relating to “charitable purposes, failure of” in column 1, for “sections 63 and 65” substitute “section 63A”;	



- (b) in the entry relating to “donor” in column 1, for “63 to 66” substitute “63A and 66”;
- (c) omit the entry relating to “prescribed (in sections 63 and 65)”.

*Amendments relating to sections 10 and 11 of this Act*

- 16 (1) In section 281 (power of unincorporated charities to spend capital: general) – 5
- (a) in subsection (2), omit “given for particular purpose”;
  - (b) in the heading, omit “unincorporated”.
- (2) In the italic heading above that section omit “unincorporated”.
- 17 (1) Section 284 (taking effect of resolution under section 282) is amended as follows. 10
- (2) In subsection (1)(a) –
- (a) after “evidence” insert “made”;
  - (b) for “the donor or donors mentioned in section 282(1)(a)” substitute “any donor or donors to the available endowment fund”. 15
- (3) In subsection (1), for paragraph (b) substitute –
- “(b) any changes in circumstances relating to the available endowment fund since it was established (including, in particular, the financial position of the fund, the needs of those who can benefit from the fund, and the social, economic and legal environment).” 20
- (4) In subsection (2)(a), for “the gift or gifts mentioned in section 282(1)(a)” substitute “any gift or gifts to the available endowment fund”.
- (5) In subsection (5)(b), for “period of 3 months mentioned in subsection (3)” substitute “relevant period”. 25
- 18 Until the commencement of the amendment in paragraph 3, in section 285 (power to alter sums specified in certain provisions) –
- (a) in subsection (1), omit from “or” in paragraph (a) to the end of paragraph (b);
  - (b) in subsection (2), in the words in brackets after “section 282(1)” omit “income level and” and “given for particular purpose”. 30
- 19 For the heading of Part 13 substitute “Powers to amend trusts and use capital”.

*Amendments relating to section 12 of this Act*

- 20 In the heading of section 285 (power to alter sums specified in Part 13), omit “sums specified in”. 35
- 21 In Schedule 11 (index of defined expressions), in the entry relating to available endowment fund for “section 281(7)” substitute “sections: 281(7) and 284A(9)”. 40

*Amendment relating to section 13 of this Act*

- 22 In section 292B (general power to make social investments), in subsection (2), after “question” insert “(but see section 104AA, which confers on charity

trustees a power to use permanent endowment to make social investments in certain circumstances”).

*Amendments relating to section 14 of this Act*

- |    |  |    |
|----|--|----|
| 23 | In Schedule 6 (appeals and applications to tribunal), omit the entry relating to the decision of the Commission not to concur under section 291 with a resolution of charity trustees under section 289(2).  | 5  |
| 24 | In Schedule 11 (index of defined expressions) –<br>(a) in the entry relating to “available endowment fund” –<br>(i) for “Parts 13 and 14” substitute “Part 13”;<br>(ii) for “sections 282(5) and 288(7) substitute “section 282(5)”;<br>(b) omit the entry relating to “the relevant charity, in relation to power to spend capital subject to special trust (in Part 14)”;<br>(c) in the entry relating to “special trust” for “section 287” substitute “section 353(4)”. | 10 |

*Amendments relating to section 16 of this Act* 15

- |    |  |    |
|----|--|----|
| 25 | In section 322(2) (reviewable decisions of the Commission), after paragraph (e) insert –<br>“(ea) not to make an order under section 106 (power to authorise ex gratia payments etc) in relation to a charity;”. |    |
| 26 | In Schedule 6 (appeals and applications to Tribunal), after the entry for a decision by the Commission not to make an order under section 105 insert –   | 20 |

- |  |  |   |    |
|--|--|---|----|
| “Decision by the Commission not to make an order under section 106 in relation to a charity. | The persons are –<br>(a) the charity trustees of the charity, and<br>(b) (if a body corporate) the charity itself. | Power to quash the decision and (if appropriate) remit the matter to the Commission.” | 25 |
|  |  |   | 30 |

PART 2

AMENDMENTS RELATING TO PART 2

*Amendment relating to sections 23 and 25 of this Act*

- |    |   |    |
|----|---|----|
| 27 | In section 118 of the Charities Act 2011 (meaning of “connected person” in section 117(2)), in subsection (2), in the words before paragraph (a), for “The” substitute “Subject to subsections (2A) and (2B), the”. | 35 |
|----|---|----|

*Amendment relating to section 24 of this Act*

- |    |  |  |
|----|--|--|
| 28 | In paragraph 4(2)(b) of Schedule 1 to the Trusts of Land and Appointment of Trustees Act 1996 (land held on charitable trusts etc), for the words from “if |  |
|----|--|--|

neither” to “conveyance” substitute “if section 122(2) or 125(1) of that Act applies to the conveyance but has not been complied with”.

### PART 3

#### AMENDMENTS RELATING TO PART 3

29 The Charities Act 2011 is amended in accordance with paragraphs 30 to 35 5

#### *Amendments relating to section 27 of this Act*

30 For the italic heading before section 42, substitute “Names and working names”.

31 In section 45 (change of name where charity is a company), in subsection (2), after “with respect to” insert “the name of”. 10

32 In section 208(2) (refusal of application for constitution and registration of charitable incorporated organisation) –

(a) in the words after paragraph (a)(ii), after “the name” insert “or a working name”;

(b) in paragraph (b), after “charity’s name” insert “or working name”. 15

33 In section 231(2) (refusal of application for conversion to charitable incorporated organisation) –

(a) in the words after paragraph (a)(ii), after “the name” insert “or a working name”;

(b) in paragraph (b), after “charity’s name” insert “or working name”. 20

34 In section 237(3) (refusal of application for amalgamation of charitable incorporated organisation) –

(a) in the words after paragraph (a)(ii), after “the name” insert “or a working name”;

(b) in paragraph (b), after “charity’s name” insert “or working name”. 25

35 In Schedule 11 (index of defined expressions), after the entry relating to “vesting declaration” insert –

“working name | section 42(4)”.

### PART 4

#### AMENDMENTS RELATING TO PART 4

36 The Charities Act 2011 is amended in accordance with paragraphs 37 to 39. 30

#### *Amendments relating to section 32 of this Act*

37 In section 187 (meaning of “benefit” etc) –

(a) in the heading omit “, “services””;

(b) omit the definition of “services”. 35

38 In Schedule 11 (index of defined expressions) omit the entry for “services”.



## Appendix 4: Explanatory Notes on the draft Charities Bill

### WHAT THESE NOTES DO

- 1.2 These explanatory notes relate to the draft Charities Bill, which gives effect to the recommendations made by the Law Commission in its report on Technical Issues in Charity Law, published on 14 September 2017.<sup>1197</sup> They have been produced by the Law Commission in order to assist the reader of the draft Bill and to help inform debate on it.
- 1.3 These explanatory notes set out what each part of the draft Bill will mean in practice, provide background information on the development of policy, and provide additional information on how the draft Bill will affect existing legislation in this area. These explanatory notes are intended to be read alongside the draft Bill. They are not intended to be a comprehensive description of the draft Bill.

### OVERVIEW OF THE DRAFT BILL

- 1.4 The draft Charities Bill (“the Bill”) gives effect to the Law Commission’s recommendations to reform various technical issues in the law governing charities. It does so primarily by amending the Charities Act 2011 (“the Charities Act”) but also by amending other legislation such as the Universities and College Estates Act 1925 and the Trusts of Land and Appointment of Trustees Act 1996.
- 1.5 Charities legislation is commonly perceived as being complicated, uncertain and in places unduly burdensome. This can delay or prevent a charity’s activities, discourage people from volunteering to become trustees and force charities to obtain expensive legal advice. It also prevents the Charity Commission from efficiently regulating the sector.
- 1.6 If enacted, the Bill would do the following.
- (1) Give charities wider or additional powers and flexibility:
    - (a) to amend their governing documents;
    - (b) to decide on how they procure goods and services;
    - (c) to make “ex gratia” payments (which charities have a moral obligation, but no legal power, to make).
  - (2) Clarify when property can be applied cy-près, including the proceeds of failed fundraising appeals.

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<sup>1197</sup> Technical Issues in Charity Law (2017) Law Com No 375.

- (3) Produce a clearer and less administratively burdensome legal framework for buying, selling, leasing and mortgaging charity land.
- (4) Clarify and expand the statutory regime that applies to permanent endowment.
- (5) Introduce a power – with appropriate safeguards – for charities to borrow from their permanent endowment and to make certain social investments using permanent endowment.
- (6) Facilitate, where appropriate, charity mergers and incorporations.
- (7) Confer additional powers on the Charity Commission:
  - (a) to authorise charities to pay an equitable allowance;
  - (b) to require charities to change or stop using inappropriate names; and
  - (c) to ratify the appointment or election of charity trustees where there is uncertainty concerning the validity of their appointment or election.
- (8) Improve and clarify certain powers of the Charity Tribunal.

## **POLICY BACKGROUND**

1.7 This project originated from the Law Commission's Eleventh Programme of Law Reform, published in July 2011. The Programme explained that the project would comprise, in part, certain issues arising from the review of the Charities Act 2006 by Lord Hodgson of Astley Abbots which concluded in 2012. Government and the Law Commission first agreed terms of reference for the project in June 2013, and they were later updated to include a review of certain aspects of the law relating to social investment by charities and again to review the law relating to the use of permanent endowment. The Law Commission consulted on, and then published, its recommendations on social investments in 2014, and its recommendations for statutory reform were implemented in the Charities (Protection and Social Investment) Act 2016. The Law Commission consulted on the remaining issues in its project in 2015, with a supplementary consultation in 2016, and published its final recommendations in its report *Technical Issues in Charity Law* in 2017.

1.8 Further information on the policy and background to the Law Commission's recommendations is provided in its final report and the consultation papers which preceded it.<sup>1198</sup>

## **LEGAL BACKGROUND**

1.9 The first definition of charity was set out in the preamble to the Statute of Charitable Uses 1601. Since then there have been numerous statutes and regulations refining the definition of charitable purposes and regulating charities' activities in a number of ways. In modern times, significant changes were introduced by the Charities Act 1960 and the

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<sup>1198</sup> *Technical Issues in Charity Law* (2015) Law Commission Consultation Paper No 220; and *Technical Issues in Charity Law, Supplementary Consultation* (2016), both available at [www.lawcom.gov.uk](http://www.lawcom.gov.uk).

Charities Act 1992, which was followed by a consolidation Act in 1993. Further important developments were introduced in the Charities Act 2006, which was again followed by a consolidation in the Charities Act 2011.

1.10 The key legislation and regulations impacted by the Bill are:

- (1) the Charities Act 2011;
- (2) the Charities (Qualified Surveyors' Reports) Regulations 1992;
- (3) the Charities (Total Return) Regulations 2013; and
- (4) the Universities and College Estates Act 1925.

## **TERRITORIAL EXTENT AND APPLICATION**

1.11 This Bill extends to England and Wales only, subject to certain exceptions. Clause 26, Schedules 1 and 2, and paragraphs 12 and 43 of Schedule 3, extend as far as the enactments to which they apply, which in some cases will be narrower, and in others broader, than the general application of the Bill: see clause 45 of the Bill.

## **COMMENTARY ON PROVISIONS OF THE BILL**

1.12 The Bill is in seven parts: Part 1 deals with charities' purposes, powers and governing documents; Part 2 charity land; Part 3 charity names; Part 4 charity trustees; Part 5 charity mergers; Part 6 legal proceedings involving charities; and Part 7 other general provisions. The Bill contains 45 clauses and 3 schedules.

### **Part 1 – Purposes, powers and governing documents**

#### ***Charitable companies***

Clause 1 – Alteration of charitable company's purposes

1.13 Clause 1(2) amends section 198(2)(a) of the Charities Act, which defines those amendments of a charitable company's articles which will constitute a "regulated alteration" of its objects (companies have "objects" under the Companies Act 2006, whereas charities have "purposes" under the Charities Act; the two terms are synonymous). The amendment means that an alteration to the statement of the company's objects which does not alter the substance of the charitable purposes of the company will not constitute a "regulated alteration". However, it also means that an amendment other than to the statement of the company's objects, which nonetheless alters the substance of the company's charitable purposes, will constitute a regulated alteration.

1.14 The following are some examples of an amendment "which alters the charitable purposes of the company".

- (1) A change in the geographical area of benefit, for example "for the benefit of the residents of X parish". Changing this to "for the benefit of the residents of Y parish", or "X and Y parish", or a wider geographical area that included X parish, would be a regulated alteration.

- (2) A change to a part of the statement of purposes which sets out the means of achieving those purposes, for example changing “the advancement of education by the provision of a school” to “the advancement of education” would be a regulated alteration. Contrast this with a change to a part of the statement of purposes which merely gives an example of how the purposes might be achieved: changing “the advancement of education including, but not limited to, by the provision of a school” to remove reference to the provision of a school would not be an alteration to the charitable purposes of the company.
  - (3) For certain charities, such as almshouse charities, the criteria for beneficiaries is so fundamental to the charity’s purposes that an amendment to those provisions would constitute an alteration of the charitable purposes of the company.
- 1.15 The amendment reflects the description of a “regulated alteration” of a CIO’s constitution in section 226(2)(a) of the Charities Act.
- 1.16 Clause 1(3) inserts a new subsection into section 198 of the Charities Act. The new subsection sets out the matters which the Charity Commission must consider in deciding whether or not to give consent to an alteration of a charitable company’s purposes. Clause 2(3)(b) replicates that provision for CIOs.
- 1.17 The new considerations broadly reflect the matters which the Charity Commission must have regard to, under section 67(3) of the Charities Act, when changing the purposes of an unincorporated charity by way of a cy-près scheme. However, the reference to “the spirit of the original gift” is replaced with “the purposes of the company when it was established” in recognition of the fact that there may not always be an identifiable “original gift”.
- 1.18 The new considerations are the same as those which the Charity Commission will have to consider in deciding whether to consent to an alteration to the purposes of an unincorporated charity under the new section 280A(10), inserted by clause 3(2). Accordingly, the Bill creates consistency in the matters that the Commission must consider when deciding whether to consent to a change of purposes by a charity, regardless of whether the charity is a company, CIO, or unincorporated charity.
- 1.19 The amendment to section 337 of the Charities Act by clause 41 of the Bill confers on the Charity Commission a discretionary power to give notice of a proposed amendment, or to require the charity to give such notice, before consenting to a regulated alteration.

## **CIOs**

### Clause 2 – Amendments to constitution of CIOs

- 1.20 Clause 2 aligns the process for the amendment of a CIO’s constitution with the process for a charitable company.
- 1.21 Clause 2(2) inserts a new subsection into section 224 of the Charities Act. The new subsection requires CIOs to send to the Charity Commission a copy of a resolution under section 224 amending its constitution, as well as a copy of the constitution as amended and any other documents that the Commission requires. This is in line with the requirement under section 26(1) of the Companies Act 2006, but without creating a criminal offence for failure to comply.



- 1.22 Clause 2(3) amends section 226 of the Charities Act by substituting subsection (1) and introducing three new subsections: (2A), (2B) and (2C).
- 1.23 New subsection (2A) sets out the matters which the Charity Commission must consider in deciding whether or not to give consent to an alteration of the purposes of a CIO. This subsection replicates that provision for companies: see paragraphs 1.16 to 1.18 above.
- 1.24 New subsection (2B) provides for amendments to a CIO's constitution to take effect on the date that the resolution containing the amendment is passed, or on a later date specified in the resolution. New subsection (2C) creates an exception for an alteration of the CIO's purposes, which take effect only when registered by the Commission, or on a later date specified in the resolution. The replacement subsection (1) ensures that any regulated alteration cannot take effect unless the Charity Commission has given its prior consent, despite the provisions in new subsections (2B) and (2C). It is, however, possible to pass a resolution that is not expressed to take effect until the Charity Commission has given its consent. Such conditional resolutions can already be made by companies, and it will now be possible for CIOs to pass similar resolutions. These amendments align the taking effect of amendments to the constitution of a CIO with the taking effect of amendments to a charitable company's articles of association.
- 1.25 Clause 2(4) repeals section 227 of the Charities Act (registration and coming into effect of amendments) as its function is replaced by the amendments to section 226.
- 1.26 The amendment to section 337 of the Charities Act by clause 41 of the Bill confers on the Charity Commission a discretionary power to give notice of a proposed amendment, or to require the charity to give such notice, before consenting to a regulated alteration.

### ***Unincorporated charities***

#### Clause 3 – Powers of unincorporated charities

##### *Repeal of certain existing powers*

#### 1.27 Clause 3(1) repeals :

- (1) the power under sections 267 to 274 of the Charities Act for certain unincorporated charities (with an income of £10,000 or less and which do not hold designated land) to resolve to transfer all their property to another charity;
- (2) the power under sections 275 to 279 of the Charities Act for a small unincorporated charity (with an income of £10,000 or less and no designated land) to alter its purposes; and
- (3) the power under section 280 of the Charities Act for any unincorporated charity to modify administrative provisions in its governing document.

It replaces these specific powers with a new general power to amend the governing documents of an unincorporated charity under new sections 280A and 280B: clause 3(2). A resolution passed under sections 268(1), 275(2) or 280(2) of the Charities Act prior to the commencement of clause 3 will not be affected by the repeal of sections 267 to 280: clause 3(3).

*The new power under section 280A: general*

- 1.28 The new power introduced by clause 3(2) is intended to be a wide power for unincorporated charities (whether trusts or unincorporated associations) to amend any provision in their governing documents. The term “trusts” in section 280A has the meaning given in section 353(1) of the Charities Act, namely the provisions establishing a charity as a charity and regulating its purposes and administration, whether those provisions take effect by way of trust or not.
- 1.29 Subject to the express restrictions set out in section 280A(2) and (3), that the amendment must be expedient in the interests of the charity and that the power cannot be exercised in a way which would result in the institution ceasing to be a charity, and the general duties on trustees, there is no limitation on the type of amendment that may be made under the power. The power could be used, for example, to give the trustees more powers than they have under the existing governing document. Any amendment that could have been made under sections 267 to 280 can be made under the new section 280A.
- 1.30 The power cannot be excluded or modified by a charity’s governing document, and it applies in addition to any other amendment powers that are available to the charity trustees.

*Regulated alterations*

- 1.31 While new section 280A provides unincorporated charities with a power to amend any provision in their governing documents, certain amendments will require the written consent of the Charity Commission. Those amendments are set out in subsection (8). Subsection (8)(a) to (c) reflects the amendments which would be “regulated alterations” (under sections 198 and 226 of the Charities Act) if they were made by a charitable company or CIO. Examples of amendments that would fall within section 280A(8)(a) are given in paragraph 1.14 above. Subsection (8)(d) to (f) provides for amendments that are specific to unincorporated charities. Subsection (8)(e) (in combination with subsection (9)) provides that an amendment that would have required the consent of a person (other than a trustee or member of the charity) is a regulated alteration, unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence.
- 1.32 Subsection (8)(f) (in combination with subsection (9)) provides that any amendment which would “affect any right directly conferred by the trusts of the charity” on a named person, or the holder of an office or position specified in the trust of the charity (other than that of a trustee or member) is a regulated alteration, unless that person consents to the amendment or has died or (if a corporation or other body) is no longer in existence. Trustees and members are excluded from the definition on the basis that their rights are adequately protected by the requirement that they pass a resolution to exercise the amendment power.
- 1.33 The following amendments would generally be regulated alterations:
- (1) changing a power for X to nominate trustees for appointment;
  - (2) changing a power for X to set the spiritual direction of a faith charity;

- (3) changing a requirement for X to consent to certain decisions or proposed amendments;
- (4) changing a right for X to be consulted on a particular matter;
- (5) changing a right for X to receive certain documents;
- (6) changing the named recipient of the charity's property in a dissolution clause; and
- (7) introducing a power to merge in circumstances where Charity X is named as the recipient of property in the event of dissolution, and the creation of the power to merge renders the dissolution clause redundant.

1.34 On the other hand, the following amendments would not be regulated alterations:

- (1) changing the right of trustees to co-opt further trustees (since trustees are excluded from the definition);
- (2) changing the rights of members to appoint or remove trustees, or the requirement for members to ratify certain decisions (since members are excluded from the definition);
- (3) changing the rights of a category of people (such as the residents of a particular neighbourhood) to vote on certain matters (since they are not named persons, and do not hold a particular office or position specified in the governing document); and
- (4) changing provisions that confer benefits on individuals who are not named in the governing document, or provisions that confer indirect benefits, such as the benefits to a supplier of goods or services to the charity being affected by an amendment which causes the charity to stop purchasing those goods or services.

1.35 Subsection (8)(g) ensures that any amendment which would give the trustees a power to make a regulated alteration, for example, a power to change the charity's purposes, is itself a regulated alteration.

1.36 New section 280B, subsections (3), (4) and (5), provide further definition of the amendment described at section 280A(8)(c). The definition of "benefit" is consistent with the definition in section 199 of the Charities Act<sup>1199</sup> which applies for the purposes of the equivalent regulated alteration for charitable companies. The definition of persons who are connected with the charity is consistent with section 200 of the Charities Act which defines a "connected person" for the purposes of the equivalent regulated alteration for charitable companies.

1.37 Schedule 3, paragraphs 5 to 7 amend sections 350, 351 and 352 of the Charities Act to ensure that the definitions of particular connected persons (child, spouse and civil

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<sup>1199</sup> As amended by paras 40 and 41 of Schedule 3 to the Bill, so as to exclude the provision of indemnity insurance authorised by section 189 from the meaning of "benefit".

partner; controlled institution; and substantial interest in body corporate) in those sections apply to the new section 280A(8)(c).

- 1.38 The amendment to section 337 of the Charities Act by clause 41 of the Bill confers on the Charity Commission a discretionary power to give notice of a proposed amendment, or to require the charity to give such notice, before consenting to a regulated alteration.

*Amendment to the charity's purposes*

- 1.39 Section 280A(10) lists the matters which the Charity Commission must have regard to in deciding whether to give effect to an amendment which would alter the purposes of a charity. These are the same matters that the Commission must consider if the Commission is deciding whether to consent to a change of purposes by a charitable company or CIO (see clauses 1 and 2, and paragraphs 1.16 to 1.18 and 1.23 above).

*Passing a resolution under the new power*

- 1.40 Section 280A, subsections (4), (5) and (6), set out how to pass a resolution under the new power. The operation of the power depends on the governance structure of the charity in question.

- (1) If the charity has a membership body which has a decision-making role under the charity's governing document (for example, an entitlement to attend a general meeting and vote on the appointment of the trustees or to vote on the charity's reports and accounts), a resolution must be passed by a majority of the trustees and by a further resolution of those members.<sup>1200</sup> The members' resolution must be passed either:
  - (a) by at least 75% of those voting at a general meeting;<sup>1201</sup> or
  - (b) unanimously if the resolution is not considered at a general meeting (for example, it might be practical for a small membership body to approve the resolution by email).
- (2) If the charity does not have a membership body (which will be the case for most charitable trusts), the power is exercisable by a resolution of 75% of the charity's trustees.

*Taking effect of a resolution passed under the new power*

- 1.41 The new section 280B, subsection (1), sets out when a resolution under section 280A takes effect. The resolution takes effect on the latest of:
- (1) the date that it is passed;
  - (2) the date specified (if any) in the resolution for it to take effect;

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<sup>1200</sup> If the members request an amendment to the resolution, the trustees will need to pass a fresh resolution reflecting that amendment and then put it to the members a second time.

<sup>1201</sup> The provision also permits a resolution to be passed without the need for a vote, provided there is no expression of dissent by any member at the meeting.

- (3) if the charity has a separate body of members which needs to approve the resolution of the trustees, the date on which such approval is obtained; or
- (4) if the amendment makes a regulated alteration which requires Charity Commission consent, the date on which the Charity Commission gives consent.

Section 280A(7) provides that, notwithstanding section 280B(1), no amendment that makes an alteration requiring Charity Commission consent (under subsection (8)) can take effect unless and until that consent is obtained. However, the trustees can obtain Charity Commission consent before or after passing the resolution and/or putting it to the membership for approval.

### ***Charities established etc by Act or Royal charter***

#### Clause 4 – Power to amend Royal charter

- 1.42 Clause 4 inserts a new section 280C into the Charities Act, which provides charities established or regulated by Royal Charter with a new statutory power to amend any provision in their Royal Charter.<sup>1202</sup> The power will assist Royal Charter charities that do not currently have an express power of amendment and which must therefore petition, and pay, for a supplemental Charter if they wish to amend the Charter. Many Royal Charters contain an express power of amendment, which is tailored to the charity. If a proposed amendment could be made under an existing express power in the Charter, that procedure must be followed and the power in section 280C is not available: section 280C(2)(b).
- 1.43 The power is exercisable by resolution and subject to the approval of Her Majesty by Order in Council. Subsection (4) describes the process for passing a resolution in the case of a charity that has a membership body which has a decision-making role under the Charter. This process is similar to that for unincorporated charities with a membership body that must pass a resolution under the new section 280A: see paragraph 1.40 above.
- 1.44 In order to avoid potentially wasted costs of putting a proposed amendment to a vote of the charity's membership, only for the amendment to be refused, charities should speak to the Privy Council Office at an early stage of the process. That will enable potential problems to be resolved, and the Privy Council Office to indicate approval in principle to the proposed amendment, before the resolution is put to a vote of the charity's membership.
- 1.45 Unlike amending a Royal Charter under section 68 of the Charities Act, the new power under section 280C will not require a Charity Commission scheme. Once the resolution has been approved by Order in Council the resolution itself will serve to modify the Royal Charter.
- 1.46 Schedule 3, paragraph 42 amends the description of Royal Charter charities in section 292B(4)(b) to reflect the definition used in section 68 of the Charities Act and in the new section 280C.

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<sup>1202</sup> The power will not be available to amend Royal Charters which incorporate a trustee body which is not itself a charity.

## Clause 5 – Orders under section 73 of the Charities Act 2011: parliamentary procedure

- 1.47 Section 73 of the Charities Act provides a mechanism for amending a statute establishing or regulating a charity by secondary legislation. Clause 5 amends section 73 of the Charities Act so that all schemes will be subject to the negative procedure, regardless of whether it is amending a private or public general Act.

### ***Cy-près and schemes***

## Clause 6 – Cy-près powers

- 1.48 When donors respond to a fundraising appeal by a charity for a particular purpose (such as a fund for the victims of a particular natural disaster, or a fund for building a new church hall), and those purposes cannot be carried out, there is an “initial failure” of the charitable purposes. That is to be contrasted with a “subsequent failure”, which arises where a surplus remains after the particular purposes of the fundraising appeal have been achieved. In the case of an initial failure of the charitable purposes for which a gift is given, the gift is only applicable for other purposes (that is, applicable “cy-près”) if the donor had a “general charitable intention”. When a gift is given for particular charitable purposes in response to a fundraising appeal, the donor will not have a general charitable intention. The default position, therefore, is that the donations must be returned to the donors.
- 1.49 Clause 6(1) inserts section 63A into the Charities Act to replace the current regime (in sections 63 to 65) that allows certain donations given for particular purposes which have failed to be applied cy-près rather than having to be returned to the donors (or paid in to court if the donors cannot be found). Provisions concerning particular forms of “disclaimer” to be executed by donors, and concerning particular statements to be included in fundraising literature by charities, are repealed. They are replaced by four circumstances in which a donation to a failed appeal can be applied cy-près.
- 1.50 Section 63A(1)(a) and (2) re-state section 64(2), allowing donations to be applied cy-près if the court or Charity Commission decides that it would be unreasonable to incur expense in taking steps to return the donation, or it would be unreasonable for the donors to expect the donation to be returned.
- 1.51 Under section 63A(3), if a donor has given a total of £120 or less in one financial year (whether in a single donation, or cumulatively over the year), that donation can be applied cy-près. Accordingly, charities will not need to take steps to contact donors of relatively small sums to offer the return of their donations. A donor can, however, prevent this provision from operating by expressly stating that he or she wishes the donation to be returned in the event of the fundraising appeal failing. If such a declaration has been made, then the property is not applicable cy-près under 63A(3). But that does not prevent the property from being applicable cy-près by reason of the other conditions in section 63A, which apply regardless of a donor’s stated wishes.
- 1.52 Section 63A(3) works by looking at each individual gift and ascertaining, first, whether it is a gift of £120 or less, and second, whether the total gifts given by the donor in the financial year exceeded £120. For example:

- (1) A donor has given £10 per month during the financial year, totalling £120. No individual donation exceeded £120, and the total given by the donor did not exceed £120. All 12 donations of £10 would therefore fall within section 63A.
  - (2) A donor has given two separate gifts of £50 and £20. No individual donation exceeded £120, and the total given by the donor (£70) did not exceed £120. Both donations will therefore fall within section 63A.
  - (3) A donor has given two separate gifts of £80 and £100. No individual donation exceeded £120, but the total given by the donor (£180) exceeded £120. Neither donation will fall within section 63A(3).
- 1.53 The provision applies to donations made by any means, including standing order, bank transfer or cheque. The threshold of £120 applies to the amount given by the donor, so would not include any Gift Aid that the charity might claim on the donation.
- 1.54 Section 63A(4) and (5) allows the charity to agree with the Charity Commission the reasonable steps that it should take to attempt to identify and find donors to a failed fundraising appeal, in order to offer them a refund of their donation. Donations can then be applied cy-près if, after taking those steps, the donor cannot be identified or found. This power to agree steps that are tailored to the charity and the particular fundraising appeal replaces the rigid and detailed requirements for prescribed advertisements and inquiries set out in the Charities (Failed Appeals) Regulations 2008, which are repealed by clause 6(2).
- 1.55 Section 63A(6) re-states section 64(1), allowing donations from unidentifiable donors to be applied cy-près.
- 1.56 Clause 6(3) provides that the new section 63A operates from the date of commencement, even if the donations to the fundraising appeal were given before commencement and even if the fundraising appeal failed before commencement.

#### Clause 7 - Trustee powers to apply property cy-près

- 1.57 Where the proceeds of a failed fundraising appeal are applicable cy-près, those funds can only be used for other charitable purposes if the Charity Commission makes a cy-près scheme. Clause 7 inserts a new section 67A into the Charities Act, which allows charity trustees to apply the proceeds of a failed fundraising appeal to other purposes, without the need to obtain a cy-près scheme. Where the proceeds exceed £1,000, the charity trustees must obtain the consent of the Charity Commission.
- 1.58 The power is available whenever proceeds from a fundraising appeal are applicable cy-près (section 67A(1)).
- (1) In the case of an initial failure of the appeal (typically where insufficient funds have been raised so the purpose of the appeal cannot be achieved), the default position is that the requirement for, and absence of, a general charitable intention prevents the proceeds from being applicable cy-près. That default position is ameliorated by section 63A (inserted by clause 6(1)). The proceeds will therefore only be applicable cy-près if a condition in section 63A is satisfied.

- (2) In the case of a subsequent failure of the appeal (where there is a surplus after achieving the purpose of the appeal), there is no requirement for a general charitable intention and the proceeds are therefore applicable cy-près without the need to consider section 63A. Such proceeds will be applicable cy-près by virtue of section 62(1)(a) or (b).
- 1.59 The section 67A power is exercisable by the charity trustees passing a resolution that the proceeds should be used for different charitable purposes. In making that decision, the trustees must have regard to two matters in section 63A(2), which broadly mirror the considerations that must be taken into account by the Charity Commission when it is deciding (i) whether to consent to an unincorporated charity changing its purposes under section 280A (see clause 3), (ii) whether to consent to a charitable company or CIO changing its purposes under sections 198 and 226 (see clauses 1 and 2), and (iii) whether to make a cy-près scheme (see section 67).
- 1.60 If the proceeds do not exceed £1,000, the resolution of the trustees under section 67A takes effect immediately. If the proceeds exceed £1,000, the resolution takes effect when the Charity Commission consents to it: section 67A(4). To ascertain whether a resolution can take effect without Charity Commission consent based on the value of the proceeds not exceeding £1,000, it is necessary to calculate the total value of all the donations to a single appeal that are applicable cy-près. If a fund comprises two donations of £5,000 (which are not applicable cy-près because s63A does not operate) and 90 donations of £10 (which are applicable cy-près because s63A(3) operates), the total value of donations in the fund that are applicable cy-près is £900 (i.e. 90 x £10). The section 67A resolution in respect of those donations totalling £900 would not require the consent of the Charity Commission. The fact that the fund also includes £10,000 which is not applicable cy-près does not mean that the trustees need Charity Commission consent in respect of their resolution to use the £900 (which is applicable cy-près) for other purposes.
- 1.61 The amendment to section 337 of the Charities Act by clause 41 would give the Charity Commission a discretion to require the trustees to publicise the resolution (or to publicise it itself) and seek representations on it before consenting to it.

#### Clause 8 – Power of the court and the Commission to make schemes

- 1.62 The court and the Charity Commission can make “schemes” in respect of charities. Schemes are legal arrangements that change or supplement the provisions that would otherwise apply in respect of a charity or a gift to charity. In response to doubts as to whether the scheme-making power extends to corporate charities, clause 8 inserts a new section 75ZA into the Charities Act. Section 75ZA confirms that any power to make schemes in respect of a charitable trust extends to charitable companies, CIOs or any other charity. The section is subject to the other provisions of the Charities Act, so the special scheme-making procedures for charities established or regulated by Royal Charter (in section 68) and by statute (in section 73) will continue to govern schemes made in respect of those charities.
- 1.63 This power is treated as always having had effect so as not to cast doubt on the validity of any scheme made before commencement. The new section does not restrict or curtail any existing powers of the court or the Charity Commission to make schemes under the Act or otherwise.



### ***Permanent endowment***

#### Clause 9 – Definition of “permanent endowment”

1.64 Clause 9 replaces the definition of “permanent endowment” in section 353(3) of the Charities Act with a new, simplified definition. The new definition:

- (1) removes the redundant definition of a charity which is treated as having permanent endowment, and retains a definition of what permanent endowment means;
- (2) removes any presumption that a charity holds permanent endowment; and
- (3) removes superfluous and confusing words from the definition.

1.65 It defines when property will be considered permanent endowment for the purposes of the Charities Act, namely if it is subject to a restriction on expenditure which distinguishes between income and capital.

1.66 Examples of permanent endowment under this definition could include the following types of asset.

- (1) A gift of shares subject to a restriction that only the income from the shares (i.e. dividends) can be spent to further the purposes of the charity.
- (2) A gift of property subject to a restriction that the property itself cannot be sold and the proceeds applied for the purposes of the charity, but the rental income may be spent on those purposes.
- (3) A property that can only be used for carrying out the charity’s purposes, for example, to house beneficiaries at below market rent (sometimes referred to as “functional endowment”). The rental income could be spent but it is not possible to sell the property and spend the proceeds.

1.67 Under this definition a fund restricted to being spent for a particular purpose (for example, to repair the roof of the village hall) is not permanent endowment unless there is a restriction on the capital of that fund being spent for that purpose. Such a fund would, however, amount to a “special trust” under section 353(4) (as inserted by clause 14(2); see paragraph 1.86 below).

#### Clause 10 – Amendment of powers to release restrictions on spending capital

1.68 Sections 281 and 282 of the Charities Act allow charities to release the restrictions on spending permanent endowment capital. The power in section 281 can be exercised by the charity trustees alone and exercise of the power in section 282 is subject to the oversight of the Charity Commission. Both powers are limited to charities which are not companies or other bodies corporate.

1.69 Clause 10(1) amends section 281 of the Charities Act 2011 to extend the statutory power to release restrictions on spending the capital of permanent endowment to corporate charities.

- 1.70 Subsection (2) amends section 282 of the Charities Act in three respects. First, it makes section 282 available to corporate charities, similarly to section 281 as amended: see paragraph 1.69 above. Second, it makes section 282 applicable to funds even if they do not consist entirely of property given by a particular person (or persons) for a particular purpose. Accordingly, the mere fact that a permanent endowment fund comprises some capital that originates from accumulated income (as opposed to a donation of capital by a donor) does not enable the charity trustees to use the section 281 power and therefore avoid oversight by the Charity Commission. Instead, the sole criterion which determines the availability of the section 281 or 282 powers (and thus the need for Charity Commission oversight) is the value of the permanent endowment fund. Third, it raises the market value of funds to which the section applies to funds exceeding £25,000. The gross income of the charity in question will no longer be relevant to determining whether the section 281 or section 282 power can be exercised as the new threshold focuses solely on the market value of the fund.
- 1.71 Schedule 3, paragraph 17 amends section 284 of the Charities Act in consequence of the removal by clause 10 of the reference to capital that is entirely given by a particular individual or individuals for a common purpose. Section 284, as amended, requires the Charity Commission, in determining whether or not to concur with a section 282 resolution, to consider the wishes of any donor(s) to the permanent endowment fund (if evidence of such wishes is made available to it). Where property has been identified as having been given by a particular person or persons with particular wishes, these wishes should be taken into account. Sub-paragraph (3) amends section 284(1)(b) so that the inquiry into any change of circumstances is based on changes since the fund was established, rather than since the date of individual gifts to the fund.
- 1.72 Schedule 3, paragraph 18 amends section 285 of the Charities Act, which grants the Secretary of State the power to alter sums specified in Part 13 by order, to account for changes made by clause 10 to section 282(1) of the Charities Act.

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

- 1.73 Clause 11 amends the time limit (in section 284 of the Charities Act) for the Charity Commission to respond to a section 282 resolution to the “relevant period”, defined in substituted subsection (4). The starting point is that the “relevant period” is 60 days from the date on which the Commission received the copy of the resolution. This time period is suspended in cases where the Commission directs the charity trustees to give public notice of a resolution or to provide information or explanations in accordance with new subsections (4A) and (4B).
- 1.74 For example, Charity X passes a resolution under section 282 and sends a copy of the resolution together with a statement of the reasons for passing it to the Charity Commission on 1 January. The Commission receives the resolution on 2 January. The Commission must notify the trustees of whether or not it concurs with the resolution before the end of the “relevant period”.
- (1) In a straightforward case the relevant period would end on 3 March, namely 60 days after the Commission received the resolution on 2 January.
  - (2) However, the Commission decides to exercise its power under section 283(1)(a) and on 5 January directs the charity trustees to give public notice of the

resolution, which they do on 10 January. The relevant period runs for 3 days, from 2 January when the Commission received the resolution, to 5 January when it gave the direction to the trustees, causing the relevant period to be suspended with 57 days remaining. The relevant period will begin to run again from 21 February, namely 42 days from 10 January when the trustees give public notice of the resolution, for the remaining 57 days. The relevant period would end on 19 April.

- (3) The Commission then decides, on 1 April, to exercise its power under section 283(2), and direct the charity trustees to provide it with additional information regarding the circumstances in which they have decided to act under section 282. The trustees provide this information on 10 April. The relevant period will have run for 3 days, from 2 January when the Commission received the resolution, to 5 January when it was suspended by the 283(1) direction; and then for a further 39 days, from 21 February to 1 April, when it is suspended by the 283(2) direction; meaning that 18 days remain. The period will begin to run again from 10 April when the information is provided to the Commission. The relevant period will therefore end on 28 April.

1.75 If the Commission exercises its power under both sections 283(1) and (2) at the same time, the relevant period would be suspended until the later of:

- (1) 42 days from date on which the charity trustees give public notice of the resolution; or
- (2) the date on which the trustees provide the information or explanations required by the Commission.

#### Clause 12 – Power to borrow from permanent endowment

1.76 Clause 12 creates a new statutory power for a charity to borrow from its permanent endowment under sections 284A, 284B and 284C. There is some overlap between this power and the powers under sections 281 and 282 to release permanent endowment. However, the power to borrow is more restrictive; it enables trustees to borrow a limited amount from the fund, subject to repayment. Trustees could therefore opt to use this power where they do not think it would be appropriate, or in the best interests of the charity, to release the restrictions on spending completely.

1.77 The new power can be exercised in relation to any “available endowment fund” of the charity, meaning the entirety of the charity’s permanent endowment if it is subject to the same trusts or any part of it subject to particular trusts: see section 284A(9). Borrowing is limited to the “available amount” as defined in section 284B and must be repaid within 20 years of being borrowed. The effect of exercising the power is to release the amount borrowed from the restrictions on spending capital which applied to it when it was part of the permanent endowment fund.

### **Example 1(a)**

Charity X holds an investment portfolio worth £100,000 subject to a restriction that only income from those investments can be spent in furtherance of the charity's objects. The charity has no other permanent endowment. The investment assets constitute the entirety of the "available endowment fund". The trustees of Charity X resolve to borrow £20,000 from the permanent endowment fund. The effect is to release £20,000 worth of assets from the restriction so that they can be sold and the proceeds of that sale used to further the purposes of the charity. The trustees of Charity X will need to make arrangements for the £20,000 to be repaid within 20 years. This requires Charity X to increase the value of the capital in the endowment fund (now reduced to £80,000 worth of assets) by £20,000 within that time. The £20,000 paid back into the endowment fund will be subject to the same restriction on the spending of capital as the rest of the fund.

- 1.78 Section 284A(10) clarifies how the power operates where a charity has opted in to investing on a total returns basis by passing a resolution under section 104A(2). The effect of subsection (10) is to limit the "available endowment fund" – from which the trustees may resolve to borrow – to the value of the fund representing the capital of the permanent endowment in respect of which the section 104A(2) resolution was passed (which the Charities (Total Return) Regulations 2013 refer to as the "trust for investment"). This excludes any returns from the investment of that fund which have not been accumulated to it (the "unapplied total return" in the 2013 Regulations).

### **Example 1(b)**

Charity X decided to invest its £100,000 permanent endowment on a total return basis. It is invested in a variety of shares. The trustees passed a section 104A(2) resolution in respect of that fund. On the date on which the resolution took effect the capital of the fund was valued by the trustees at £100,000 and this forms the trust for investment. A year later the capital value of the shares has increased to £110,000 and they have paid a dividend of £5,000, providing a total return of £15,000. Charity X has not yet applied any of this return to the trust for investment nor has it spent it on furthering its purposes. Charity X wants to borrow from its permanent endowment under section 284A. The "available endowment fund" from which it can borrow is £100,000, the value of the initial investment fund excluding the £15,000 unapplied total return on that investment. If, however, Charity X decides to apply £2,000 of the investment return to the investment fund, the "available endowment fund" from which it can borrow increases to £102,000.

- 1.79 Section 284B provides the formula for calculating the "permitted amount" which can be borrowed under section 284A. It is designed to ensure that a charity cannot borrow more than 25% of the total capital value of the available endowment fund (although if the value of the remaining capital subsequently falls, the result might be that the charity's outstanding borrowing exceeds 25% of the total capital value of the

endowment fund). In calculating the available amount, “V” is the value of the available endowment fund from which the trustees are seeking to borrow. It does not include the value of any other permanent endowment that is subject to separate trusts, for example functional permanent endowment. “V” is defined as the value of the available endowment fund on the “relevant date”, namely, the date on which the trustees resolve to borrow from the fund. This does not require the trustees to seek a valuation on the same day that they pass the resolution but it will require them to use a fairly recent valuation, and if the trustees have reason to believe that the valuation is out of date by the time they pass the resolution they should obtain a fresh valuation.

**Example 2(a)**

On 1 January, Charity Y had permanent endowment valued at £100,000. On 30 January the charity trustees resolved for the first time to borrow £10,000 from the fund. On 1 June the trustees want to calculate how much more money they could borrow from the fund under section 284A if they passed a resolution that day. To calculate the available amount they must first identify “V”, the value of the charity’s permanent endowment on the relevant date. The relevant date is 1 June and, assuming the value of the fund has remained static since the initial borrowing on 30 January, “V” is £90,000. They must then identify “B”, the total outstanding borrowing from permanent endowment on that date. “B” is £10,000. The available amount is therefore  $(0.25 \times (£90,000 + £10,000)) - £10,000 = \underline{£15,000}$ .

**Example 2(b)**

On 1 January 2017 Charity Z had permanent endowment valued at £100,000 comprising £50,000 worth of shares and an investment property worth £50,000. On 30 January the trustees resolved to borrow £5,000, selling shares to realise that sum. On 1 June the trustees resolve to borrow a further £10,000, again selling shares to realise that sum. On 1 September the trustees repay £5,000 of their borrowing by purchasing £5,000 worth of shares to be held subject to the same restrictions as the rest of the permanent endowment fund. On 1 January 2018 the trustees want to calculate the maximum amount they can borrow from the fund. The investment property is now valued at £55,000 but the shares have remained at the same value. The total value of the shares is therefore £40,000. “V” is therefore £95,000 (the value of the property plus the shares on 1 January 2018). “B” is £10,000 (the total borrowing of £15,000 minus the £5,000 repaid). The available amount is therefore  $(0.25 \times (£95,000 + £10,000)) - £10,000 = \underline{£16,250}$ .

- 1.80 Example 2(b) assumes that Charity Z’s investment property is held within the same “available endowment fund” as the £50,000 worth of shares. The calculation would be different if the property were held on separate trusts, or if it were held subject to a restriction that it be used solely for the purposes of housing beneficiaries of the charity (that is, functional permanent endowment). In that case the permitted amount calculation would be based on an available endowment fund of £50,000, the value of the shares alone.
- 1.81 Section 284A(2)(b) requires charity trustees exercising the power to put in place arrangements for the amount borrowed to be repaid within 20 years of being borrowed.

That 20-year period runs from the date on which the borrowing is drawn-down, and not from the date of the trustees' resolution to borrow (if that date is different). The charity's compliance with that plan will need to be accounted for in whatever form of accounts the charity in question is required to prepare.

- 1.82 Section 284A(5) allows the trustees, when re-paying an amount borrowed from permanent endowment, to pay an additional sum (the "maximum estimated capital appreciation"). That additional sum reflects the fact that, had the trustees not borrowed from permanent endowment, the capital value of the permanent endowment might have increased (for example, in Example 2(b) above, the capital value of the shares might have increased). The decision whether to pay an additional sum must be made in the light of the trustees' general duty of even-handedness, that is, to balance the interests of current and future beneficiaries. If, for example, the amount borrowed would otherwise have been placed in an interest-bearing bank account (as part of a mix of investments across the portfolio as a whole), the capital value of that sum would have remained unchanged, so the trustees are unlikely to pay an additional sum. If, by contrast, the remaining permanent endowment fund is invested in assets which yield an income but no capital appreciation, the trustees might decide that they should pay an additional sum in an attempt to maintain the capital value of the permanent endowment in real terms. The maximum estimated capital appreciation is capped in line with an inflation index to be chosen by the trustees: section 284C.
- 1.83 Section 284D requires trustees to seek an order from the Charity Commission providing directions as to how to proceed if at any time they do not think they will be able to repay the borrowing as required under section 284A. Section (2) lists, non-exhaustively, some suggestions as to what such directions could include.

#### Clause 13 – Total return investment

- 1.84 Clause 13 creates a new power, by inserting section 104AA into the Charities Act, to use permanent endowment to make social investments, within the meaning of section 292A. The new power is limited to charities that have already opted in to investing on a total return basis under section 104A(2). The power will enable charities to use the fund to make social investments which they would not otherwise be able to make because they are expected to produce a loss. New regulations governing the use of the fund to make social investments will apply to the fund. Clause 13(3) amends section 104B of the Charities Act to enable the Charity Commission to make these regulations.

### **Example 3**

Charity Z is a housing charity which has permanent endowment with a capital value of £100,000 when it passes a section 104A resolution in respect of the fund. The trust for investment is valued at £100,000. The trustees want to use £50,000 to purchase Property A to be occupied by its beneficiaries at a low rent. The trustees know that the capital value of the property is likely to decrease over time and that the modest income from rent is unlikely to cover this depreciation in value. However, the trustees wish to use the money in this way because it will both further the charity's purposes and make some financial return (within the meaning of section 292A). They also believe that they can recoup any loss over time through investing the remaining £50,000 in shares which they believe will appreciate in value and pay dividends. They cannot currently purchase Property A using permanent endowment because section 104A of the Charities Act and the Charities (Total Return) Regulations 2013 require trustees to invest the trust for investment (and the unapplied total return) to produce a return. Making a social investment which is expected to produce a negative financial return does not constitute an investment for the purposes of section 104A or the TRI Regulations. However, Charity Z can pass a resolution under section 104AA enabling it to use the trust for investment (and the unapplied total return) to make social investments. The charity can choose to pass the resolution in respect of the entirety of the fund (£100,000) or only in respect of the £50,000 part of it that they wish to use to make the social investment.

- 1.85 Schedule 3, paragraph 22 amends section 292B of the Charities Act to create an exception to section 292B(2) which otherwise precludes the use of the power in section 292B to make social investments with a negative financial return using permanent endowment.

### ***Special trusts***

Clause 14 – special trusts

- 1.86 Clause 14 repeals Part 14 of the Charities Act which deals with special trusts. Subsection (2) inserts a new subsection into section 353 of the Charities Act to define a “special trust”. The definition replicates the existing section 287. All other provisions in Part 14 (sections 288 to 292) are redundant since they replicate the power under sections 281 and 282.

### ***Ex gratia payments etc***

Clause 15 – Small ex gratia payments

- 1.87 Clause 15 confers on charity trustees a power to make ex gratia payments up to a certain level without requiring authorisation from the Charity Commission under section 106. The test for whether an ex gratia payment can be made is the same as under

section 106 (as amended by clause 16), namely whether there is a moral obligation but no legal power to make the payment (as established in *Re Snowden*).<sup>1203</sup>

- 1.88 The quantum of an ex gratia payment that the charity trustees can make without the Commission's oversight is set by reference to the charity's gross income in its last financial year: section 331A(3)(a) and (6)). The threshold applies per payment, not per financial year. So the maximum ex gratia payment that could be made by a charity with a gross income of £200,000 in its last financial year would be £2,500, and if the charity wished to make two separate ex gratia payments in one year of £2,000 each, it would be able to do so using the new power.
- 1.89 The financial thresholds can be amended by regulations: section 331B. The power can be excluded in the charity's governing document: section 331A(4).
- 1.90 It had been decided that the Attorney General had no power to authorise ex gratia payments by a statutory charity, where to do so would involve the contravention of a statutory prohibition on the disposal of the charity's assets.<sup>1204</sup> Clause 15 operates by conferring a stand-alone statutory power on charity trustees to make small ex gratia payments, and will therefore allow statutory charities to make small ex gratia payments even if the governing Act contains a general prohibition on the charity's assets being used otherwise than for the charity's purposes. The power will also be capable of use in respect of Royal Charter charities whose governing documents include a similar prohibition on using the charity's assets otherwise than for the charity's purposes, since a statute takes precedence over a Charter. Nevertheless, to put the matter beyond doubt in respect of statutory charities, section 331A(5) makes clear that the existence of such a prohibition of itself should not be treated as an exclusion of the power.

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

- 1.91 Clause 16(a) inserts new subsections 106(1), (1A) and (1B) into the Charities Act, codifying the test for making ex gratia payments to put it on a statutory basis.
- 1.92 Under section 106(1)(b), an ex gratia payment can be made if the charity trustees "could reasonably be regarded" as being under a moral obligation. The test is based on the decision in *Re Snowden*,<sup>1205</sup> but confirms that the charity trustees need not *personally* decide whether to make an ex gratia payment, but can delegate that function as part of the general delegation of functions in the charity's governance structure.
- 1.93 Ex gratia payments are unusual, and the power to make such payments "is not to be exercised lightly or on slender grounds".<sup>1206</sup> The new test introduces an element of objectivity, so as to enable trustees (should they wish to do so) to delegate the decision. It remains the case that charities have a power, not an obligation, to make ex gratia payments. Accordingly, even if the trustees could reasonably be regarded as being

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<sup>1203</sup> [1970] Ch 700.

<sup>1204</sup> *Attorney General v Trustees of the British Museum* [2005] EWHC 1089 (Ch), [2005] Ch 397.

<sup>1205</sup> *Re Snowden* [1970] Ch 700.

<sup>1206</sup> *Re Snowden* (above), at p 710.



under a moral obligation to make such a payment, there is no legal obligation to make the payment and no automatic expectation that a payment will be made.

- 1.94 Overall responsibility for the decision to make ex gratia payments (as with any other decision made by a charity) still lies with the charity trustees. It will be for trustees to decide whether they wish to decide all ex gratia payments personally, or whether they wish to delegate the decision to make some or all ex gratia payments.
- 1.95 As noted in paragraph 1.90 above, it had been decided that the Attorney General had no power to authorise ex gratia payments by a statutory charity.<sup>1207</sup> The new section 106(1) creates a stand-alone statutory power for the Commission, court and Attorney General to authorise ex gratia payments. The power can therefore be exercised in relation to any charity, including a charity established and regulated by statute whose governing Act contains a general prohibition on the charity's assets being used otherwise than for the charity's purposes. The power will also be capable of use in respect of Royal Charter charities whose governing documents might include a similar prohibition on using the charity's assets otherwise than for the charity's purposes, since a statute takes precedence over a Charter. Nevertheless, to put the matter beyond doubt in respect of statutory charities, the new section 106(1A) makes clear that the section 106(1) power to authorise ex gratia payments is not limited if an Act contains such a general prohibition.

## Part 2 – Charity Land

### *Dispositions and mortgages*

#### Clause 17 – Scope of Part 7 of the Charities Act 2011

- 1.96 Part 7 of the Charities Act imposes restrictions on disposals of charity land to ensure that charities obtain the best terms before disposing of land. The regime can only sensibly operate when the decision to dispose of the land lies with the charity, as opposed to (say) a trustee holding the land on trust for multiple beneficiaries, only one of which is a charity. Clause 17 amends section 117 of the Charities Act to clarify the meaning of land held “by or in trust for a charity”. New section 117(1A) confirms that the restrictions on dispositions of land only apply to land where the whole of the land which is being disposed of is held beneficially by a charity solely for its own benefit (if it is a corporate charity) or in trust solely for that charity (if it is an unincorporated charity). “A charity” means a single charity and “land” includes an interest in land. Accordingly, the restrictions will apply:
- (1) where a charity owns land both legally and beneficially;
  - (2) where a trustee holds land on bare trust for a single charity;
  - (3) where land is left to a charity in a will and the executor has appropriated the land to the charity; or
  - (4) where a charity owns land as one of several tenants in common but is disposing of only its share.

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<sup>1207</sup> *Attorney General v Trustees of the British Museum* [2005] EWHC 1089 (Ch), [2005] Ch 397.

However, the restrictions would not apply:

- (1) where a charity is one of several beneficial joint tenants of land and the entirety of the land is being disposed of by the trustee of the land;
- (2) where a charity is one of several tenants in common of the land and the entirety of the land is being disposed of by the trustee of the land;
- (3) where land which is being disposed of is left to, and has been appropriated or assented to, multiple beneficiaries under a will, one or more of which is a charity;  
or
- (4) where a trustee holds land on trust for multiple beneficiaries, one or more of which is a charity.

#### Clause 18 – Exceptions to restrictions on dispositions or mortgages of charity land

1.97 Clause 18 amends the exceptions to the general restrictions on dispositions and mortgages of charity land set out in sections 117(3) and 124(9) of the Charities Act.

1.98 Subsections (2)(a) and (3)(a) insert a new subsection (aa) into sections 117(3) and 124(9) of the Charities Act which provides that a disposition or mortgage of charity land by a liquidator, provisional liquidator, receiver, mortgagee or administrator is not subject to the restriction under section 117(1) or 124(1) respectively. Obtaining the best terms for the proposed disposition or mortgage is secured by the general duties of the liquidator, provisional liquidator, receiver, mortgagee or administrator, rather than by requiring the charity trustees (who have no decision-making role in the transaction) to obtain particular advice.

1.99 Subsections (2)(b) and (3)(b) remove the exception for dispositions or mortgages which would have required the authorisation or consent of the Secretary of State under the Universities and College Estates Act 1925 (under sections 117(3)(b) and 124(9)(b)). This reflects the amendments to the UCEA 1925 which remove any involvement of the Secretary of State in approving such transactions (see clause 26 and paragraph 1.112 and following below).

1.100 Subsection (2)(c) substitutes section 117(3)(c) with a new subsection which clarifies when a disposition of charity land made to another charity will be excluded from the restriction in section 117(1). The exception as amended will apply where the disposition both (1) is intended to be at less than the best price that can reasonably be obtained, and (2) is not a social investment (as defined in section 292A of the Charities Act). This will ensure that in cases where the price obtained as a result of the disposition is a motivating factor (even if only a partial one in the case of a social investment) charities will have to comply with the advice requirements in Part 7 which are designed to protect against disposals at an undervalue. The new subsection (c) removes the requirement under the existing subsection (c)(ii) that the disposition be authorised by the trusts of the charity. This is intended to clarify that no express provision in the trusts of the charity authorising the disposition is required in order for it to fall within the exception. It is not intended to permit charities to make dispositions which they would not be authorised to make under the trusts of the charity.

**Example 4(a)**

Charities A and B have similar purposes. Charity A wishes to transfer its assets and operations to Charity B. The land owned by Charity A is to be transferred to Charity B for a nominal sum. In effect, the trustee of the land is changing from Charity A to Charity B; the charitable purposes for which the land is held remain the same. The section 117(3)(c) exception would apply to this disposition because the price paid by Charity B is not a motivating factor in Charity A's decision to dispose of the land.

**Example 4(b)**

Charity A, a homelessness charity, owns a long lease of a flat worth £100,000. It wants to sell the lease to Charity B, another homelessness charity, for £80,000 to be used for providing accommodation to homeless people at a low rent. The transaction is motivated by both the financial return (the purchase price of £80,000) and the direct furtherance of Charity A's purposes (the provision of accommodation for homeless people). It is therefore a social investment, and the section 117(3)(c) exception would not apply. Charity A will need to obtain advice in accordance with Part 7 in order to proceed with the transaction. Equally if Charity A was trying to sell the flat for the best price possible, perhaps because it wanted to liquidate the asset and spend the proceeds of sale on furthering its purposes, then the fact that it was selling to another charity would not be sufficient for the section 117(3)(c) exception to operate. Charity A would still need to obtain advice in accordance with Part 7.

**Clause 19 – Repeal of section 121 of the Charities Act 2011**

1.101 Clause 19 removes the additional requirements in section 121 of the Charities Act concerning advertising proposed disposals of designated land and considering any responses received. Schedule 1 makes amendments consequential upon this repeal: clause 19(2).

**Clause 20 – Advertising and report requirements for disposition of charity land**

1.102 Clause 20(a) removes the automatic statutory requirement under section 119(1)(b) to advertise a proposed disposition as advised in the surveyor's report. The charity must consider any advice on advertising that is given by the surveyor (or other designated adviser), but there is no longer a statutory requirement to follow that advice. Clause 20(b) removes the superfluous requirement, in section 119(4), that a surveyor's report, must "contain such information" as may be prescribed by regulations made by the Secretary of State, leaving instead a general requirement that such reports "deal with such matters" as may be prescribed by regulations. These amendments reflect updated regulations prescribing the contents of reports under section 119(1) (see draft Charities ([Designated Advisers'] Reports) Regulations 2017 at Appendix 5).

**Clause 21 – Advice relating to the disposition of charity land**

1.103 Regulations made under section 119(3)(a) can prescribe the requirements a person must satisfy in order to provide a charity with advice on disposals of charity land. The

implementation of the Charities ([Designated Advisers]) Regulations 2017 (see Appendix 5) will expand the category of advisers under Part 7 of the Charities Act to include fellows of the National Association of Estate Agents and fellows of the Central Association of Agricultural Valuers. Clause 21 amends section 119 to substitute references to “qualified surveyor” with “designated adviser”. That term better reflects the expanded category of advisers who may not be members of the Royal Institution of Chartered Surveyors.

#### Clause 22 – Advice etc from charity trustees, officers and employees

1.104 Clause 22(2) inserts a new section 128A into the Charities Act to provide that charity trustees, officers and employees of a charity can provide a report or advice under sections 119(1)(a), 120(2)(a), 124(2) and 124(7), including if they do so in the course of their employment by the charity.

1.105 Subsection (3) repeals the second part of section 124(8) which states that advice under section 124 may be provided by a person in the course of their employment as an officer or employee of the charity or its trustees. That provision is rendered redundant by reason of the new section 128A, which applies also to advice provided under sections 119 and 120.

#### Clause 23 – Residential tenancies granted to employees

1.106 Employees of a charity fall within the definition of a connected person for the purposes of section 117(2). Disposals of charity land to an employee are therefore prohibited unless they are authorised by the Charity Commission. Clause 23 amends section 118 of the Charities Act to create an exception to the prohibition in the case of the grant of a short fixed-term or periodic tenancy to an employee of a charity to use as their home. It will still be necessary to obtain advice on the grant of such a lease, but there will no longer be a requirement for Charity Commission consent.

#### Clause 24 – Information to be included in certain instruments

1.107 Generally, there are two stages to land transactions. First, the seller and buyer enter into a contract, in which they agree that on a future date the seller will transfer the land to the buyer and the buyer will pay the purchase price (“the contract”). Second, on that future date, the parties complete the transfer by executing a conveyance and paying the purchase price (“the conveyance”).

1.108 Clause 24 amends the wording to be included in instruments concerning dispositions (both contracts and conveyances) and mortgages of charity land, and sets out protections for purchasers from charities. Some of the amendments substitute clearer wording with little substantive effect on how the provisions operate. There are two significant amendments. The first concerns the wording to be included in a contract. The effect of subsection (2) is to require a statement to be included in the contract stating, as applicable, that the requirements in Part 7 of the Charities Act (under section 117(1), 119(1) or 120(2)) have been complied with. That is, that the trustees have obtained and considered relevant advice, or the court or Charity Commission has authorised the transaction. This is in addition to the same statement which must be included in the conveyance effecting the disposition. The person responsible for providing these statements will be the same person responsible for executing the contract or conveyance.

1.109 The second amendment concerns the protection of purchasers. As is currently the case with the statement in the conveyance, the statement in the contract is now conclusively presumed to be true in favour of the person enforcing the contract. Also as is currently the case with a conveyance, where the statement is required but has been omitted, then, in favour of a person who has entered into the contract in good faith, the contract is enforceable as if the trustees had complied with the requirements in Part 7 of the Charities Act. Accordingly, a charity cannot rely on its failure to comply with Part 7 of the Charities Act in order to avoid completing a contract for the disposal of an interest in land (a problem that was highlighted in *Bayoumi v Women's Total Abstinence Educational Union Ltd*).<sup>1208</sup>

### **Connected persons**

Clause 25 – “Connected person”: wholly-owned companies etc.

1.110 Clause 25(2) amends section 118 of the Charities Act to allow for dispositions to a company, CIO or other corporate body which is wholly-owned by the charity making the disposition. Such dispositions would otherwise be prohibited (unless authorised by the Charity Commission) as a disposition to a connected person within the meaning of section 118(2)(g) and (h) which, together with sections 351 and 352, provide that certain institutions or bodies corporate are connected persons for the purposes of section 117(2). This provision would include a chain of subsidiaries, namely, a subsidiary of the subsidiary of the charity. However, it only applies to a subsidiary that is wholly-owned by a *single* charity. The effect of removing wholly-owned subsidiaries from the definition of connected persons is to remove the need to obtain Charity Commission consent ahead of making a disposition to them. The charity making the disposition will still need to comply with the applicable advice requirements under Part 7.

1.111 Clause 25(3) inserts a new section 128B into the Charities Act which requires notice to be given to the Charity Commission where a charity disposes of land to a wholly-owned subsidiary using the exception created by clause 25(2). Notice must be given within 14 days of the disposition and must include a copy of the advice obtained in compliance with Part 7 (either the written advice, or a summary of unwritten advice).

### **UCEA 1925**

Clause 26 – Universities and College Estates Act 1925

1.112 Clause 26 replaces the numerous and complex powers which the Universities and College Estates Act 1925 (“the UCEA”) confers on the institutions to which it applies with a consolidated general statutory power in respect of land transactions. It also removes the requirement to obtain Ministerial consent (from Defra) prior to entering into certain types of transaction, and removes restrictions and powers in relation to dealing with capital money.

1.113 Subsection (2) inserts a new section 1A, “General power over land” into the UCEA. This confers on a university or college to which the UCEA applies all the powers of an absolute owner in relation to its land. The new section 1A(2) states that the exercise of this general power is subject to restrictions imposed by statute, common law, equity or the institution’s own governing documents. The fact that the new power is set out in

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<sup>1208</sup> [2003] EWCA Civ 1548 [2004] Ch 46.

statute does not, therefore, mean that the transaction is excepted from Part 7 of the Charities Act 2011 by virtue of section 117(3)(a). Instead, the general power is subject to the requirements in Part 7 concerning disposals of land by charities as amended by clauses 17 to 25 (unless the requirements in Part 7 do not apply for other reasons, for example, if the institution is an exempt charity).

- 1.114 Subsection (3) omits the numerous existing powers and restrictions contained in the UCEA which are replaced by the new general power.
- 1.115 Subsection (4) removes the requirement to obtain Ministerial consent prior to the transfer to a university or college of lands vested in individual members thereof.
- 1.116 Subsection (5) removes unnecessary wording from section 42, the remainder of which is retained to maintain the position that powers conferred under the UCEA, now consolidated in the general power, are in addition to any existing powers.
- 1.117 Subsection (6) omits from the definitions in section 43 terms which have now been omitted from the UCEA by subsection (3).
- 1.118 Finally, subsection (7) gives effect to Schedule 2 containing amendments to other enactments consequential upon the amendments to the UCEA under clause 26.

### **Part 3 – Charity names**

#### Clause 27 – Working names etc

- 1.119 Clause 27 confers enhanced power on the Charity Commission to require charities to change, or stop using, unsuitable names. The clause distinguishes between a “name” (the charity’s formal name, which will usually be set out in its governing document), and a “working name” (a name under which a charity carries out its activities). For example, the Royal National Institute of Blind People uses “RNIB” as its working name.
- 1.120 The Commission can issue a direction under section 42 requiring a charity to change its formal name in five situations. Clause 27(2) extends the scope of those directions to working names, so that a section 42 direction can both (a) require a charity to change its formal name, and (b) require a charity to stop using a working name (the charity could still use one or more different working names instead).
- 1.121 The first basis on which the Commission can issue a direction under section 42 is if the charity’s formal name (or, as a result of the amendments mentioned above, its working name) is the same as, or too like, the formal name of another charity. The direction can only be given on this ground if the first charity is registered and provided that the direction is given within 12 months of registration of its name. Clause 27(2)(c)(i) amends that provision in two ways. First, it allows such a direction to be given to a charity even if it is not registered (and, if it is registered, regardless of whether the direction is given within 12 months of registration of its name), therefore creating consistency between all five situations in which a section 42 direction can be issued. Second, it allows a direction to be given if the similarity is with another charity’s working name.
- 1.122 Paragraphs 32 to 34 of Schedule 3 make equivalent changes to the provisions concerning the power of the Commission to refuse applications to register a CIO, to convert to a CIO, and to amalgamate CIOs; registration can be refused if the proposed

name is the same as, or too like, not just the formal name but also the working name of another charity.

- 1.123 Paragraph 43 of Schedule 3 amends the Companies Act 2006 to make clear that, when a section 42 direction has been issued to a charitable company, the name of the company can be changed by a resolution of the directors (rather than requiring a resolution of the members, as is usually the case for a change of name by a company).

#### Clause 28 – Power to delay registration of unsuitably named charity

- 1.124 Clause 28 inserts section 45A into the Charities Act, which confers on the Charity Commission a discretion to delay the registration of a charity if it has issued a direction under section 42 requiring the charity's name to be changed. The power removes the requirement for the Commission to register the charity while there is an unresolved problem with the charity's name.

- 1.125 The delay cannot, however, last indefinitely. The delay may last until the earlier of (1) the charity trustees complying with the section 42 direction and notifying the Charity Commission that they have done so, or (2) the "maximum postponement period" expiring (section 45A(2)). Since the power to delay registration is a discretionary power for the Commission, the stay can also end on an earlier date if the Commission so decides. The maximum postponement period is a longstop. The stay will come to an end before the expiry of the maximum postponement period if the charity trustees notify the Commission that they have complied with the direction. But if they do not comply with the direction the power to delay registration will come to an end on the expiry of the maximum postponement period. The maximum postponement period is 60 days from the expiry of the date for compliance under the section 42 direction (section 45A(3)).

- 1.126 The 60-day clock stops running if "relevant proceedings" have been started and are ongoing (section 45A(4) to (7)). Relevant proceedings are defined to include challenges that might be made to the Commission's decision to issue the section 42 direction or to other enforcement action taken by the Commission in respect of the section 42 direction. Relevant proceedings also include proceedings for contempt of court under section 336. The maximum postponement period is suspended during this period since the Commission has no control over the timescale for such proceedings; the duration of the proceedings will depend on the timetable set by the Tribunal or court (and, in the case of challenges to the section 42 direction or other enforcement action, will also depend on the actions of the complainant). The 60-day clock starts running again once the relevant proceedings have been concluded and the time limit for any appeal has passed (section 45A(7)).

- 1.127 In summary, therefore, following expiry of the deadline for compliance set out in the section 42 direction, the Commission has 60 days to take enforcement action in order to compel the charity to change its name. If enforcement action is not taken (or does not result in the charity's name being changed) within that 60 day period, the stay expires and the Commission must register the charity. But the 60-day period is suspended for the duration of any legal challenges to the section 42 direction or to any associated enforcement action.

#### Clause 29 – Power to delay entry of unsuitable name in register

1.128 Clause 29 inserts section 45B into the Charities Act, which permits the Charity Commission to delay the registration of a change of name by a charity if it has issued a direction under section 42 requiring the charity's new name to be changed. The clause makes equivalent provision as clause 28 concerning the maximum length of the delay and the suspension of that maximum period when relevant proceedings are ongoing.

#### Clause 30 – Power to direct change of name of exempt charity

1.129 Clause 30 allows the Commission to issue a section 42 direction to an exempt charity. Before doing so, section 28 requires the Commission to consult with the exempt charity's principal regulator.

### **Part 4 – Charity trustees**

#### Clause 31 – Powers relating to appointment of trustees

1.130 Clause 31 inserts a new section 184B into the Charities Act, which allows the Commission to resolve uncertainties or defects in the appointment or election of charity trustees.

1.131 The Charities Act contains a functional test to ascertain who, in any particular charity, is a "charity trustee"; if a person has "general control and management of the administration of a charity" then he or she is a "charity trustee": section 177. "Charity trustee" is therefore a description of some underlying role, the performance of which amounts to control and management. The definition would include, for example, the directors of a charitable company, the trustees of a charitable trust, and the members of the management committee of an unincorporated association. Since there is no definitive list of the different roles that fall within the definition of "charity trustee", clause 31 introduces the concept of a "qualifying position", which is any position that results in the holder being a "charity trustee" under section 177: section 184B(3). Section 184B(4) provides that the qualifying position need not be a position in the charity itself. So if a charity's governing document provides that its board of governors (who are the "charity trustees" under section 177) is to include the vicar of a particular parish, that underlying role of vicar would be a "qualifying position".

1.132 If there is uncertainty as to whether a person has been appointed or elected to a qualifying position, or if there has been a defect in such an appointment or election, section 184B allows the Commission to ratify – prospectively – the appointment or election. An order can only be sought with the consent of the person who would be the subject of the ratification order. Section 184B is a stand-alone power which is designed for cases where there is uncertainty about the validity of an appointment or election (or it is known that the appointment or election was invalid), so as to avoid the need to repeat the appointment or election process. The Commission does not have to decide the question of whether or not there was in fact a valid election or appointment before exercising the power; it is enough that the election or appointment might not be valid. In some cases, it might be that the Charity Commission's existing powers to appoint trustees (under sections 69 and 80 of the Charities Act 2011) could be used instead of section 184B.

1.133 If the Commission makes an order under section 184B(2), then the Commission can in appropriate cases also make an order vesting or transferring property, as it could on



the appointment or removal of a trustee under section 69 of the Charities Act 2011: section 184B(5)(a). In addition, it can confirm the validity of acts done by that person before the order was made: section 184B(5)(b).

#### Clause 32 – Remuneration of charity trustees etc providing goods or services to charity

1.134 Charity trustees are not permitted to make any gain from their position as trustees. The starting point, therefore, is that trustees – and persons connected with them – cannot be paid for the provision of services (such as building, cleaning, accountancy or legal services) or for the provision of goods (such as building supplies or stationery). Section 185 of the Charities Act provides charities with a default power to pay charity trustees, or persons connected with them, for the provision of services to the charity, if no other power is available to them.

1.135 Clause 32 amends that provision in two ways. First, clause 32(a) to (c) extends section 185 to the provision of goods, whether that is solely the provision of goods, or the provision of goods and services together. Accordingly, charities will be able to pay a trustee (1) to decorate the charity’s premises, (2) to supply paint that can be used to decorate the charity’s premises, or (3) to do both. Charities will no longer be required to seek Charity Commission authorisation for such payments. The same safeguards in section 185 that apply to payments for the provision of services will apply to payments for the provision of goods.

1.136 Second, clause 32(d) provides that the statutory power to pay for the provision of goods or services applies in addition to any other power that the charity might have to make such a payment. Charities can therefore choose whether to use the statutory power to make the payment or an express power (if available), but they will no longer be prevented from using the statutory power simply because the payment could be made under an express provision in the charity’s governing document (that is, the “trusts” of the charity: see the definition in section 353(1) of the Charities Act 2011). Charities will not, therefore, need to scrutinise their governing document to assess whether the proposed payment can be made under an express provision. Rather, they can rely on the default statutory power (and the guidance issued by the Charity Commission concerning the exercise of the power), provided the proposed payment is not expressly prohibited by the charity’s governing document.

1.137 Section 185 does not currently permit trustees to be paid for the provision of services as a trustee, nor to be paid as an employee of the charity. That position is not changed by clause 32.

#### Clause 33 – Remuneration etc of charity trustees etc

1.138 The court has an inherent jurisdiction, in exceptional circumstances, to order the payment of remuneration to a trustee (or the retention of an unauthorised benefit received by the trustee) in connection with work that has been undertaken by the trustee for the benefit of the trust (“an equitable allowance”).<sup>1209</sup> The court’s power applies to payments to charity trustees in respect of work that they have done for the charity.

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<sup>1209</sup> *Re Duke of Norfolk’s Settlement Trust* [1982] Ch 61.

Clause 33 confers on the Charity Commission a power to order a charity to remunerate a trustee (or to authorise a trustee to retain a benefit already received) where:

- (1) the trustee has done work for the charity; and
- (2) it would be inequitable for the trustee not to be remunerated for that work (or not to retain the benefit received in connection with that work).

1.139 The Commission's power will prevent the need for an application to court to authorise the payment of an equitable allowance.

1.140 In deciding whether to exercise the power, the Commission is required to have regard to the matters in section 186A(4). One such factor is the existence of any express provision in the charity's governing document concerning remuneration. The governing documents of most charities will contain provisions prohibiting the remuneration of trustees (or setting out the circumstances in which they may be remunerated). Such express provisions would be a relevant consideration for the Commission in deciding whether to exercise the new power, but as one of many considerations it would not be decisive.

Clause 34 – Trustee of charitable trust: status as trust corporation

1.141 If land is to be held on charitable trust by a sole trustee, that sole trustee must have "trust corporation status" in order for (a) the outgoing trustees to be discharged from their responsibilities as trustees, and (b) the sole trustee to be able to deal with the land by giving a valid receipt to a purchaser. Clause 34(1) inserts a new section 334A into the Charities Act which confers trust corporation status (for the purposes of the provisions listed in section 334A(2)) on any trustee of a charitable trust that is a body corporate and itself a charity. Bodies corporate that are charities include charitable companies, CIOs, charities established by statute or Royal Charter, and certain community benefit societies. The provisions listed in section 334A(2) are the five existing statutory provisions which define, in the same terms, trust corporation status. The effect of section 334A will be to expand each of these definitions to include a body corporate that is both a charity and the trustee of a charitable trust.

1.142 Subsection (2) clarifies that trust corporation status will automatically be conferred on any trustee which meets the criteria under section 334A(1), even if that trustee became a trustee of the trust in question before the amendment came into force. This does not mean, however, that the trustee is treated as having had trust corporation status prior to the commencement of the section.

**Example 5**

Trustees X and Y are the current trustees of charitable trust A. Charitable company Z is later appointed to be trustee of charitable trust A, replacing Trustees X and Y. Trustees X and Y are discharged from their responsibilities as there will be a trust corporation to act as trustee in their place.

1.143 This provision will not be available to charities seeking to obtain trust corporation status in order to take out a grant of representation.

## Part 5 – Charity mergers

### *Gifts to merged charity*

#### Clause 35 – Gifts to merged charity

1.144 Clause 35(4) replaces the existing section 311(2) of the Charities Act with a new subsection (2) and (2A). The new subsection enables gifts to a charity which has since merged (as part of a “relevant charity merger” within the meaning of section 306) to take effect as a gift to the new charity. Under the new subsection this will be the case even where the gift specifies that it will only take effect if the charity continues to exist on the date the gift takes effect. The clause therefore overcomes the difficulty highlighted in *Berry v IBS-STL (UK) Ltd.*<sup>1210</sup> The new section 311(2) and (2A) applies to any gift made after the clause is brought into force, even if the instrument which gives rise to the gift (typically a will) was executed before commencement: clause 35(5).

#### **Example 6(a)**

In 2000 T makes a will containing a gift “to Charity A, if it continues to exist when I die”. In 2017 Charity A merges with Charity B to create a new Charity C. The merger is registered on 1 June 2017. T dies on 1 January 2018. Under the amended section 311(2) and (2A) it is necessary to consider whether the gift would have taken effect as a gift to Charity A (“the transferor”) had Charity A been in existence on the date the gift was intended to take effect. The date the gift was intended to take effect was the date of T’s death, 1 January 2018. Had Charity A still been in existence on that date the gift would have taken effect as a gift to Charity A. Therefore the new section 311(2) and (2A) operates and the gift takes effect as a gift to Charity C (“the transferee”).

#### **Example 6(b)**

Taking Example 6(a) above, Charity C subsequently transfers its operations to Charity D, following a merger, registered on 1 December 2017. Under the new section 311(2) and (2A) the gift to Charity A would still take effect as a gift to Charity D. It is necessary first to consider whether the gift would have taken effect as a gift to Charity C, had Charity C been in existence on the date the gift was intended to take effect. The answer is yes, because the gift which would have taken effect as a gift to Charity A, had it been in existence at the date of T’s death, would have taken effect as a gift to Charity C (by operation of section 311(2) and (2A)) had Charity C been in existence at the date of T’s death. Therefore because the gift would have taken effect as a gift to Charity C (now the transferor) it instead takes effect as a gift to Charity D (the new transferee).

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<sup>1210</sup> [2012] EWHC 666 (Ch), [2012] PTSR 1619.

1.145 Clause 35(2) and (3) make similar substitutions for sections 239(3) and 244(2) which apply where a CIO transfers its operations to another CIO, or where two or more CIOs amalgamate.

### ***Vesting declarations***

#### Clause 36 – Vesting declarations: exclusions

1.146 Clause 36 amends the types of property listed at section 310(3) of the Charities Act as being excluded from the transfer effected by a section 310 vesting declaration. Sub-paragraph (a) removes the first exclusion under section 310(3) which appears to refer to old (pre-1925) mortgages, which took effect by the borrower conveying the land to the lender. As mortgages are no longer granted in this way, the provision no longer serves any purpose.

1.147 Sub-paragraph (b) expressly excludes leases containing an absolute covenant against assignment (as well as leases containing a qualified covenant against assignment) from being transferred by a section 310 vesting declaration. However the requirement that the assignment would have given rise to “an actionable breach” is intended to exclude situations where the person with the benefit of the covenant (whether absolute or qualified) has consented to the assignment, agreed to release the covenant, or otherwise waived their right to enforce it.

#### Clause 37 – Vesting permanent endowment following a merger

1.148 Clause 37(1)(a) changes the reference in section 306 to a charity which has “a permanent endowment” to a charity which has “permanent endowment” in order to create consistency with the revised definition of permanent endowment in clause 9.

1.149 Ordinarily, a merger will only be a “relevant charity merger” if all property of the merging charity is transferred to the new charity, and the original charity ceases to exist. Section 306(2) modifies the definition of a “relevant charity merger” in the case of a charity with permanent endowment (“limb (a)”), and “whose trusts do not contain provision for the termination of the charity” (“limb (b)”), such that permanent endowment does not have to be transferred to the new charity, and the original charity can continue to exist. Clause 37(1)(b) removes limb (b) from the definition; the words are difficult to understand and are unnecessary. The result is that, in a rare case where the governing document of a charity with permanent endowment contains provision for the termination of the charity, a merger can still be a “relevant charity merger” even if the original charity continues to exist.

1.150 Subsection (2) repeals regulation 61 of the Charitable Incorporated Organisation (General) Regulations 2012. Regulation 61 has two primary effects.

- (1) It enables a section 310 vesting declaration to transfer permanent endowment (as well as unrestricted property) upon a merger where the transferee is a CIO.
- (2) It confers trust corporation status on a transferee CIO which holds property as a trustee by virtue of a section 310 vesting declaration following a merger.

1.151 Effect (1) is unnecessary as section 40 of the Trustee Act 1925 will already transfer legal title to the permanent endowment (which remains its own separate charity following the merger) to the transferee CIO following a merger effected by deed.

1.152 Effect (2) becomes redundant as a result of clause 34 which automatically confers trust corporation status on any CIO that is the trustee of a charitable trust.

## Part 6 – Legal proceedings

### Clause 38 – Consent for the taking of charity proceedings

1.153 Section 115 of the Charities Act prevents any “charity proceedings” from being pursued unless they have been authorised (a) by the Charity Commission or (b) if the Commission refuses authorisation, by the High Court. “Charity proceedings” are internal disputes within the charity, as opposed to disputes with outsiders. So a claim by a charity for breach of contract would not be “charity proceedings”, but a dispute concerning the administration of the charity would.

1.154 Clause 38 allows charities to seek consent to the pursuit of charity proceedings directly from the court, rather than first having to go to the Charity Commission, where the Commission would, or would appear to, face a conflict of interest in deciding whether to authorise the charity proceedings. For example, where the proposed charity proceedings would be taken in contemplation of other legal proceedings to which the Charity Commission would be a defendant, it would not be necessary to obtain authorisation to pursue the charity proceedings from the Charity Commission. Whilst the clause allows a party to seek authorisation directly from the court, so as to avoid the conflict, the party can instead choose to seek authorisation from the Commission.

### Clause 39 – Costs incurred in relation to Tribunal proceedings etc

1.155 Clause 39 inserts a new section 324A into the Charities Act. Section 324A confers on the Charity Tribunal (both the First-tier Tribunal and the Upper Tribunal) a power to make an “authorised costs order” (“ACO”). An ACO will provide charity trustees with advance assurance that any legal costs that they incur in proceedings before the Charity Tribunal are a proper use of the charity’s funds and will therefore be payable from the charity’s funds. An ACO will be equivalent to a “*Beddoe*” order<sup>1211</sup> that can be obtained from the court in respect of costs that are proposed to be incurred on behalf of a trust. The principles to be applied by the Tribunal in deciding whether to grant an ACO will be the same as those applied by the court in respect of *Beddoe* applications. The procedure for applying for an ACO will be set out in Tribunal Procedure Rules.

1.156 An application to the Tribunal for an ACO will not constitute “charity proceedings” within the meaning of section 115 because it will not be an application to a “court”. It will not, therefore, be necessary to obtain permission from the court or Charity Commission before applying for an ACO.

### Clause 40 – References by the Charity Commission to the Tribunal

1.157 Clause 40 removes the requirement for the Commission to obtain the Attorney General’s consent before making a reference to the Charity Tribunal under section 325 of the Charities Act. It is replaced by a requirement, on both the Commission and the Attorney General, that they give the other a minimum of 28 days’ notice of their intention to make a reference. A reference can be made earlier with the agreement of the other.

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<sup>1211</sup> *Re Beddoe* [1893] 1 Ch 547.

## **Part 7 – General**

### Clause 41 – Public notice of Commission consent

1.158 Before making an order under the Charities Act 2011, the Charity Commission has a discretionary power under section 337(3) to give public notice of the proposed order, or to require the charity to give such notice. Clause 41 extends that discretionary power of the Commission so that it applies whenever a provision in the Charities Act requires the *consent* of the Charity Commission. So, for example, before giving consent to a regulated alteration by a company or a CIO (under sections 198 and 226), the Commission can give public notice of the proposal, or require the charity to give public notice, before deciding whether to give consent.

### Clause 42 – “Connected person”: illegitimate children

1.159 Clause 42 amends section 350(1) of the Charities Act to remove the reference to an illegitimate child. An illegitimate child is automatically included in the meaning of “child” by virtue of section 1 of the Family Law Reform Act 1987.

### Clause 43 – “Connected person”: power to amend

1.160 Clause 43 inserts a new section 352A into the Charities Act which creates a power for the Secretary of State to make regulations amending the definition of a “connected person” for the purposes of the Act. Subsection (2) inserts references to the new power into section 348 meaning that the new power will be subject to the affirmative procedure.

### Clause 44 – Minor and consequential provision

1.161 Clause 44 gives effect to Schedule 3 which contains minor and consequential amendments.

### Clause 45 – Commencement, extent and short title

1.162 Clause 45 makes provision about the coming into force of the Bill. Clause 45 will come into effect on the day on which the Act is passed. Other provisions will come into force on such day or days as the Secretary of State may by regulations made by statutory instrument appoint. The regulations may appoint different days for different purposes, and may make transitional, transitory or saving provisions.

1.163 The extent of the draft Bill is explained in paragraph 1.11 above.

## **Schedule 1 – Repeal of section 121 of the Charities Act 2011: consequential amendments**

1.164 Schedule 1 makes amendments that are consequential on the repeal of section 121 in clause 19.

## **Schedule 2 – Universities and College Estates Act 1925: consequential amendments**

1.165 Schedule 2 makes amendments that are consequential on the amendments to the Universities and College Estates Act 1925 in clause 26.

## **Schedule 3 – Minor and consequential amendments**

1.166 Schedule 3 makes minor and consequential amendments resulting from the Bill. Where appropriate these amendments have been referred to and explained above under the clauses to which they relate.

## Appendix 5: Draft regulations relating to Chapter 7

### STATUTORY INSTRUMENTS

2017 No. [---]

### CHARITIES

### The Charities ([Designated Advisers])<sup>1212</sup> Regulations 2017

<i>Made</i>	[----]
<i>Laid before Parliament</i>	[----]
<i>Coming into force</i>	[----]

The [Secretary of State] makes the following Regulations in exercise of the powers conferred by sections 119(3)(a) and 347(1) of the Charities Act 2011.

#### **Citation and commencement**

1. These Regulations may be cited as the Charities ([Designated Advisers]) Regulations 2017 and come into force on [--] of [-----] 201[-].

#### **Designated advisers**

2. For the purposes of section 119(3)(a) of the Charities Act 2011, the prescribed requirement is that a person is –

- (a) a fellow of the Central Association of Agricultural Valuers; or
- (b) a fellow of the National Association of Estate Agents.

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<sup>1212</sup> If these Regulations are made before the implementation of the Law Commission's draft Charities Bill, references to "designated advisers" should be replaced with "qualified surveyors" since that is the term currently employed by the Charities Act 2011. The draft Charities Bill will substitute "designated advisers" for "qualified surveyors": clause 21.

## Explanatory note

These Regulations expand the category of [designated advisers] for the purposes of section 119(1) of the Charities Act 2011. They supplement the requirement that a [designated adviser] is “a fellow or professional associate of the Royal Institution of Chartered Surveyors” set out at section 119(3)(a) of the Charities Act 2011. These Regulations add two alternative requirements which can make a person a [designated adviser] for the purposes of section 119(3)(a).

These Regulations do not affect the existing requirement under section 119(3)(b) that a [designated adviser] is a person who “is reasonably believed by the charity trustees to have ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question.” [Designated advisers] must still satisfy this requirement.

The effect of these Regulations, when read together with section 119(3)(a) of the Charities Act 2011, is that a [designated adviser] is a person who:

- (1) is a fellow or professional associate of the Royal Institution of Chartered Surveyors; or
- (2) is a fellow of the Central Association of Agricultural Valuers; or
- (3) is a fellow of the National Association of Estate Agents;

and is reasonably believed by the charity trustees to have ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question.



STATUTORY INSTRUMENTS

2017 No. [---]

CHARITIES

The Charities ([Designated Advisers']<sup>1213</sup> Reports) Regulations  
2017

*Made* [---]

*Laid before* [---]

*Parliament*

*Coming into force* [---]

The Secretary of State makes the following Regulations in exercise of the powers conferred by sections 119(4) and 347(1) of the Charities Act 2011.

**Citation and commencement**

1. These Regulations may be cited as the Charities ([Designated Advisers'] Reports) Regulations 2017 and come into force on [--] of [-----] 201[ -].

**Interpretation**

2. In these Regulations—

“relevant land” means the land in respect of which a report is being obtained for the purposes of section 119(1)(a) of the Charities Act 2011; and

“the adviser” means the [designated adviser] from whom such a report is being obtained.

**Revocation of the Charities (Qualified Surveyors' Reports) Regulations 1992**

3. The Charities (Qualified Surveyors' Reports) Regulations 1992 S.I. 1992/2980 are revoked.

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<sup>1213</sup> If these Regulations are made before the implementation of the Law Commission's draft Charities Bill, references to “designated advisers” should be replaced with “qualified surveyors” since that is the term currently employed by the Charities Act 2011. The draft Charities Bill substitutes “designated advisers” for “qualified surveyors”: clause 21.

### **Matters to be dealt with in the adviser's report**

**4.** (1) A report prepared for the purposes of section 119(1)(a) of the Charities Act 2011 (requirements for dispositions other than certain leases) must deal with the following matters—

- (a) the value of the relevant land;
- (b) any steps which could be taken to enhance that value;
- (c) whether and, if so, how the relevant land should be marketed;
- (d) anything else which could be done to ensure that the terms on which the disposition is made are the best that can reasonably be obtained for the charity; and
- (e) any other matters which the adviser believes should be drawn to the attention of the charity trustees.

(2) The report must also include a statement by the adviser that—

- (a) the adviser has ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question; and
- (b) the adviser has no interest which conflicts, or would appear to conflict, with that of the charity.

### **Transitional provisions**

**5.** These Regulations do not have effect in relation to a report obtained for the purposes of section 119(1)(a) of the Charities Act 2011 before the date these Regulations come into force, even if the disposition of land to which the report relates takes place after that date.

## Explanatory note

These Regulations revoke and replace the Charities (Qualified Surveyors' Reports) Regulations 1992. The effect of these Regulations is to simplify the matters which must be dealt with in a written report made for the purposes of section 119(1)(a) of the Charities Act 2011. The Regulations seek to give designated advisers more discretion as to what information will best assist the charity trustees seeking the report in complying with section 119(1) by providing broad categories of advice which must be included.

Advice on the value of the relevant land (paragraph 4(1)(a)) would involve advice concerning what sum the trustees should expect to receive in respect of the disposal (or, if an offer has already been made, whether the offer represents the market value of the land). Advice on marketing (paragraph 4(1)(c)) would involve advice on how the land should be marketed or, if an offer has already been made, advice on any further marketing that would be desirable.

These Regulations do not invalidate any dispositions of charity land which occurred, or are yet to occur, in relation to which charity trustees obtained a written report prior to the coming into force of these Regulations. Reports obtained prior to the coming into force of these Regulations will still satisfy the section 119(1)(a) requirement if they comply with the 1992 Regulations. Reports obtained prior to the coming into force of these Regulations will not, for example, need to satisfy the self-certification requirement introduced by these Regulations. Where a written report has been obtained prior to the entry into force of these Regulations, and is compliant with the 1992 Regulations, any disposition of charity land made upon consideration of that report will comply with section 119(1)(a).

## Appendix 6: Draft regulations relating to Chapter 8

### AMENDMENTS TO THE CHARITIES (TOTAL RETURN) REGULATIONS 2013

After regulation 5, insert –

- “5A. (1) This regulation applies where the trustees make a section 104AA(2) resolution.
- (2) The trustees may use the relevant fund to make social investments that are expected to involve expenditure of the relevant fund subject to subsection (3).
- (3) A social investment that is expected to involve expenditure of the relevant fund may only be made where the trustees expect any such expenditure to be offset as part of the total return from the relevant fund.
- (4) When exercising the power under this regulation trustees should have regard to the duty set out in regulation 6(2) below.”

In regulation 2 –

insert “‘social investment’ has the same meaning as in section 292A of the Charities Act 2011”; and

in the definition of “investment return” add “less any capital losses resulting from the making of any social investments”.

## Appendix 7: Means of challenging Charity Commission decisions

<b>Key</b>			
Appeal = Charity Tribunal re-makes the decision (section 319)			
Review = Charity Tribunal considers the challenge applying judicial review principles (section 321)			
JR = challenge by judicial review to the courts			
<b>Section</b>	<b>Description</b>	<b>Decision to make the order/direction/give consent</b>	<b>Decision not to make the order/direction/give consent</b>
The general position for decisions listed in Schedule 6 to the Charities Act 2011		Appeal	JR
The general position for decisions not listed in Schedule 6		JR	JR
Some particular decisions:			
12	Linking directions	JR	Appeal
42	Direction to change name	Appeal	JR
46	Instituting an inquiry	Review	JR
69	Making a scheme/appointing or removing trustees/vesting property	Appeal	JR
76	Suspension of trustees	Appeal	JR
80	Removing or appointing trustees	Appeal	JR
96 & 100	Making a common investment scheme/common deposit scheme	JR	Review
105	Authorising any action that is expedient	JR	Review
106	Authorising ex gratia payments	JR	JR
111	Determining the identity of members of the charity	JR	JR
117	Order authorising disposal of land	JR	Review
181	Waiver of trustee disqualification	Appeal	Appeal
191	Relieving trustees from liability for breach of trust	JR	JR
198	Consenting to regulated alterations	Appeal	Appeal
251	Granting certificate of incorporation to charity trustees	Appeal	Appeal
268, 275, 282	Deciding not to permit transfer/change of purposes/release of permanent endowment restrictions	Appeal	JR

## Appendix 8: Worked examples of distribution of assets on insolvency

8.1 This Appendix contains three worked examples to demonstrate the operation of the current law of insolvency, as set out in Chapter 12

### Figure 1: availability of trust property to creditors on insolvency through rights of indemnity

B is a trust creditor

C is a personal (or corporate) creditor

The trust liabilities total £800

A is insolvent, but the “trust” is solvent

On A’s bankruptcy (or liquidation), the trustee in bankruptcy (or liquidator) can:

- exercise A’s right to exoneration to recover £700 from the trust fund, for distribution to B as a trust creditor (fully discharging A’s liability to B);
- exercise A’s right to reimbursement to recover £100 from the trust fund, increasing A’s personal (or corporate) property to £600; and
- distribute A’s personal (or corporate) property of £600 to C in partial satisfaction of A’s liability to C.

The remaining £200 of trust property cannot be touched.

### Figure 2: availability of trust property to creditors on insolvency through rights of indemnity

B is a trust creditor

C is a personal (or corporate) creditor

The trust liabilities total £1,250

A is insolvent, and the “trust” is insolvent

On A’s bankruptcy (or liquidation):

- the trustee in bankruptcy (or liquidator) can exercise A's rights of indemnity to utilise the £1,000 trust fund towards the £1,250 trust liabilities, which is likely to be distributed on a pro rata basis,<sup>1214</sup> namely 80p in the £, so that:
  - £800 is distributed to B, through A's right to exoneration. That leaves B with an outstanding debt of £200.
  - £200 is added to A's personal (or corporate) property, through A's right to reimbursement, resulting in £700 of personal (or corporate) property being available to A's creditors generally.
- the personal (or corporate) property of £700 is likely to be distributed on a pro rata basis,<sup>1215</sup> so that:
  - B, who has an outstanding debt of £200, receives £64 ( $700 \times 200/2,200$ ); and
  - C, who has a debt of £2,000, receives £636 ( $700 \times 2,000/2,200$ ).

The result is that:

- B receives £864 (namely £800 from the right to exoneration plus £64 from A's personal property) in satisfaction of his or her debt of £1,000; and
- C receives £636 in satisfaction of his or her debt of £2,000.

### Figure 3: availability of trust property to creditors on insolvency – multiple trust funds

E and F are trust creditors

<sup>1214</sup> There is no authority on the point. The authors of *Lewin on Trusts* (19th ed 2015) suggest that competing claims of trust creditors through the right to exoneration should be paid *pari passu*, saying that the alternative would be that the trust creditors would rank in order of time: para 22-45 to 22-47. But it is unclear whether rights to exoneration and rights to reimbursement should be afforded equal priority, whether one right of indemnity should have priority over the other, or whether they should rank in order of time. The cause of this uncertainty is not within the scope of our project.

<sup>1215</sup> Again, there is no authority on the point. The authors of *Lewin on Trusts* (19th ed 2015) state that, in so far as a trust creditor has not been paid from the trust fund, he or she can claim the balance ("prove his [or her] debt") as one of the personal creditors in the bankruptcy: para 22-048. The alternative argument, put forward in Australia, is that personal creditors should first be paid the proportion of their debt up to the proportion received by trust creditors through the rights of indemnity, after which any surplus personal property should be shared *pari passu* between the personal and trust creditors: see M Stephens, "Winding up corporate trustees: resolving competing interests of creditors and beneficiaries" (3 October 2001), available at <http://www.allens.com.au/pubs/insol/insoc01.htm>.

G is a personal (or corporate) creditor

The trust liabilities total £1,600

D is insolvent, but the “trusts” are solvent

Trust Funds 1 and 2 may be the same charity, or separate charities, as a matter of charity law, but that makes no difference to the analysis below

On D's bankruptcy (or liquidation), the trustee in bankruptcy (or liquidator) can:

- exercise D's right to reimbursement to recover £100 from Trust Fund 1, increasing D's personal (or corporate) property to £600 for the benefit of all of D's creditors;
- exercise D's right to exoneration to recover £700 from Trust Fund 1 for distribution to E as a trust creditor; no further sums can be recovered from Trust Fund 1 for the benefit of F or G;
- exercise D's right to exoneration to recover £800 from Trust Fund 2 for distribution to F as a trust creditor; no further sums can be recovered from Trust Fund 2 for the benefit of E or G; and
- distribute D's personal (or corporate) property of £600 to G in satisfaction of G's debt of £1,000.

The remaining balances of £200 in Trust Fund 1 and £1,200 in Trust Fund 2 remain untouched.





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