Client Briefing

The 2006 Charities Act introduces a number of changes affecting the administration and operation of charities. Some of these changes have already been implemented whilst others will not become effective until 2008 and beyond.

In this briefing we set out some of the key changes that charities and their trustees can expect to see introduced over the forthcoming months.

Charities - the new requirements

Providing public benefit

The Charities Act 2006 (the Act) establishes a statutory requirement that all charities must exist for a public benefit. Previously certain charities, including those for the advancement of education and religion, were presumed to provide such a benefit. The Charity Commission (CC) has now been charged with ensuring that there is understanding and awareness of this public benefit requirement. The CC is consulting with the charity sector and the wider public and will eventually provide guidance on what the requirement means. In the meantime charity trustees should ensure that they believe:

- the objectives set out in their charity's constitution require them to provide a public benefit
- the Trustees' report outlines that the activities of the charity are in line with its constitution
- the annual return to the CC confirms that the charity is providing a public benefit.

These changes will take effect in 2008.

New registration thresholds

There is a new basis for determining whether or not a would-be charity is required to register with the CC. Previously small charities which had an annual income of £1,000 or less did not have to register unless they had a permanent endowment or the use, or occupation, of land.

The Act removes the permanent endowment or land requirement and raises the income threshold to £5,000. In future therefore if an organisation is charitable and has an annual income of £5,000 or above it must be registered with the CC.

Existing charities with income below £5,000 will be able to ask to be removed from the register. However they will still remain as charities and have to abide by charity law.

This change is effective from 23 April 2007.

Exempt and excepted charities

Previously exempt charities have not been allowed to register with the CC as it has been presumed that they were adequately overseen by other public bodies, such as the Financial Services Authority or Housing Corporation. The new Act ensures that these charities are now also monitored for compliance with charity law.

The Act divides previously exempt charities into one of two groups:

- those entities that are already regulated by a body, other than the CC, which has agreed to ensure they meet charity law requirements. These charities will continue to be exempt and will be regulated by their current regulator, now known as a 'principal regulator'. The CC will be able to investigate these charities if there is a request from their principal regulator
- those entities where no suitable regulator exists. In this case a previously exempt charity will cease to be exempt and will have to register with the CC. All such charities will come under the jurisdiction of the CC. To ease the transition, initially only those charities with an annual income of over £100,000 are required to register. The threshold is expected to be reduced in the future, but this may be some years away.

Previously excepted charities included certain groups that did not have to register with the CC but could do so if they wished. These groups included some religious charities, Boy Scout and Girl Guide charities and some armed forces charities. In the future the Act will require these charities to register with the CC. As with the affected exempt charities discussed above, initially as a transitional measure, only excepted charities with an annual income of £100,000 or more will be required to register. Those below the £100,000 threshold will be under CC jurisdiction but will not have to register.

These changes will take effect in 2008.

Audit and independent examination of charity accounts

The Act has simplified the basis for determining when a statutory audit is required for unincorporated charities. It will also increase the statutory threshold beyond which all charities are required to subject their accounts to a professional audit. In future the test will simply be an income and asset test on the current year. It will no longer be a test of income or expenditure in the current or previous two years.

There are similar although not identical thresholds for charitable companies.

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An unincorporated charity's accounts will have to be professionally audited if the charity has:

- gross annual income over £500,000 or
- an aggregate value of assets over £2,800,000 and gross annual income over £100,000.

Below this threshold an independent examination may be performed instead of an audit. An independent examination is not required if the charity's income is below £10,000. Where the charity's income is above £250,000, the independent examiner must have an appropriate accountancy qualification.

Charitable companies will be required to have their accounts professionally audited where:

- gross annual income is over £500,000 or
- total assets on the balance sheet are over £2,800,000.

These changes have already been introduced. They take effect for accounting periods commencing on or after 27 February 2007.

The Office of the Third Sector has indicated its intention to withdraw the requirement for charitable companies, with income between £90,000 and the statutory threshold, to provide an accountant's report in order to avoid an audit. Instead the intention is to require such companies to have an independent examination. Further legislation will be brought forward in 2007 to this effect.

Deregulation of charities

The Act introduces a number of changes which will allow charities to take certain actions without prior CC permission. However the CC will continue to require copies of the resolutions passed by the trustees. The Act will also give further authority to the CC to issue rulings without the need to consult the courts. These changes include:

- transferring assets of a small charity (income less than £10,000) - trustees could transfer the charity's assets to another charity whose objects are consistent with their own
- changing the purpose of a small charity - trustees can replace their charity's purposes with new purposes provided that the changes are consistent with what the charity was set up to do
- flexibility for transferring the assets of 'failed' appeals or trusts - the Act allows the CC and the courts to take into account current social and economic circumstances when approached by charities seeking more freedom in how they can use donated money when they cannot use it as originally planned
- effective use of permanent endowment - the Act now allows a wider range of smaller charities to spend the capital and for larger charities, power to do the same in certain circumstances if the CC agrees.
- making it easier to merge - where a merger is registered with the CC, gifts and legacies to the previously separate charities will automatically be transferred to the new merged charity. This will ensure that the spirit of legacies will be honoured if a charity merges.

Most of these changes become effective later in 2007.

Charitable Incorporated Organisations (CIO)

Currently charitable companies are required to register both as charities and as companies. As a result they have dual regulation by both Companies House and the CC.

The Act makes it possible to create a new vehicle for these charities - the Charitable Incorporated Organisation (CIO). A CIO will have the advantages of a corporate structure, such as membership and reduced personal liability for trustees, without the burden of dual regulation. This part of the Act will become effective in 2008.

Fundraising

The Act introduces a number of measures to reform the area of public fundraising and also to correct some anomalies and gaps in current rules. These include:

- reforms to Fundraising Solicitation Statements - the written agreement between a charity and its professional fundraisers. The Act makes two main changes to these statements:
  - the amount to be paid to the professional fundraiser will need to be included, or if the specific amount is not known, a reasonable estimate
  - statements will also have to be made by employees, officers and trustees of charities who act as collectors, although this does not extend to volunteers
- a new system for licensing charitable collections in public. It will apply to all collections including face-to-face fundraising involving requests for direct debits. The system will require the CC to consider whether charities are fit and proper to carry out public collections and to issue a 'public collections certificate' (PCC) valid for five years. Charities holding a PCC will then need to contact the relevant local authority who will ensure that there are not too many collections taking place at the same time, in the same place
- a widening and clarification of the definition of 'public place' and 'door to door' collections
- some door to door and local short term collections will not require a certificate or permit. However charities will have to notify the local authority that a collection, such as carol singing, is taking place.

Most of this part of the Act will become effective in 2008 although the central licensing scheme is unlikely to be effective before 2009.

Payment of trustees

Trustees are not permitted by charity law to be paid simply for being trustees. They are volunteers. However the Act has introduced a change which allows a charity to pay an individual trustee who provides an additional service to the charity, provided they believe it is in the best interest of the charity. Previously this was only possible if the trustees sought permission from the CC or had a clause in their governing document permitting it.

This might, for example, enable a trustee who is also an electrician to provide electrical services to the charity provided trustees agree that it is in the charity's best interest. This may be due to the trustee charging a better price or providing a better service than the trustees could obtain elsewhere.

The key points to bear in mind are:

- the number of trustees receiving payment in this way must be in a minority
- the amount paid must be reasonable and set out in a written agreement between the trustee and the charity
- the trust or governing document must not preclude this type of payment.

These changes will take effect in 2008.

Relief from personal liability for trustees

Recruiting trustees may be difficult if they have concerns that they become personally liable for their mistakes.

Previously the courts could relieve trustees of this type of liability. Now the Act has extended this to allow charity trustees to apply to the CC, as well as the courts, for relief from personal liability for a breach of trust where the trustee has acted honestly and reasonably.

This will only apply where mistakes have been honestly made. Deliberate breaches of trust by trustees will continue to be taken very seriously.

The Act also permits trustees to use charity funds to take out trustee indemnity insurance without needing CC approval, provided there is no provision in the governing document forbidding this.

These changes were introduced with effect from 27 February 2007.

Budget 2007

In addition to the many changes in the 2006 Charities Act, new measures affecting charities were introduced by the Chancellor in the 2007 budget. These are:

- cutting the basic rate of income tax from 6 April 2008 from 22% to 20% will reduce the amount a charity will be able to reclaim on gift aid payments
- a relaxation of the rule where a benefit received by a donor is much less than the value of the gift. The transaction is effectively a donation although the donor receives something in recognition. The limit on the benefit of gifts of £1,000 or more has been 2.5% of the gift, subject to a maximum of £250. From 6 April 2007, these limits have increased to 5% and £500. This change may be helpful at charity auctions where a very large amount is paid for a trivial purchase.

If you would like to discuss any of these changes in more detail please contact us.