



Charities Focus



Registers of people with significant control Impact of the new requirements upon charities

New provisions have been inserted into The Companies Act 2006 requiring all companies after 30 June 2016 to file at Companies House a statement declaring and listing any people with significant control of the company. These provisions apply to all companies including those limited by shares and limited by guarantee. Therefore all charitable companies are required to comply with the new legislation, which also applies to trading subsidiaries of charities and community interest companies.

Charitable Incorporated Organisations, charities with Royal Charters and charities constituted by statutory corporations such as further and higher education corporations are not affected by these rules, but if they have trading subsidiaries, their trading subsidiaries will need to maintain PSC Registers.

The regulations require all companies to identify and record who effectively runs, or has a large influence over, the running of the company. The purpose of the new legislation is to increase transparency by recording individuals with significant control over companies and/or relevant legal entities with significant control.

What is a person of significant control?

A person of significant control (PSC) is defined as being a person who:

- holds directly or indirectly over 25% of the shares in a company;
- holds, directly or indirectly, over 25% of the member voting rights in a company;
- holds, directly or indirectly, the right to appoint or remove a majority of directors in the company (often referred to as charity trustees);

- otherwise has the right to exercise, or does actually exercise, significant influence or control;
- has the right to exercise, or actually exercises, significant influence or control over the activities or a trust or firm which is not a legal entity, but which itself would satisfy any of the first four conditions if it were an individual.

The first test is unlikely to be relevant to most charitable companies that are usually incorporated as companies limited by guarantee. It will apply to a small number of charitable companies that are established as companies limited by shares.

The second test is likely to catch many more charitable companies, especially those with small company memberships. In small charitable companies often the charitable company's directors (i.e. charity trustees) are the same people as the members. Therefore for a charitable company limited by guarantee which has three members with equal voting rights; all three individuals would have to be registered as persons of significant control.

The third test will also be relevant to some charitable companies. This will largely be dependent on the charitable company's Articles of Association and the make-up of the organisation. If the charitable company's Articles of Association give individuals or organisations such as trusts rights to appoint or remove directors (i.e. charity trustees) then it will also need to consider whether test three applies.

All charitable companies should consider the make-up of their organisations as to whether tests four or five apply and also whether there are any Relevant Legal Entities:

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Charity Commission's consultation on draft guidance for new warning power

The Charities (Protection and Social Investment) Act 2016 was enacted earlier this year. Its provisions are being brought into force gradually to enable the Charity Commission to consult on the exercise of its increased powers.



Amongst the Charity Commission's new powers is the power to issue official warnings to trustees or charities when the Charity Commission thinks a breach of duty or other misconduct or mismanagement has taken place.

Notice must be given by the Charity Commission to the charity and all of its trustees and the warning may be published.

The notice issued by the Charity Commission must specify:

- power and grounds for the warning;
- action the Charity Commission considers should be taken or that it is considering taking;
- whether and if so, how the notice will be published; and
- a period within which representations may be made to the Charity Commission.

The Charity Commission's draft guidance on its power to issue warnings includes information about when warnings will be issued, how much notice the Charity Commission will give and how it will publish the warnings. It states that the Charity Commission might issue warnings automatically to charities that repeatedly fail to file their accounts with the Commission on time.

The draft guidance also states that the Charity Commission will send notices by email where possible and if not possible, notices will be sent by post to the last known address. This highlights the need to keep correspondence details up to date with the Charity Commission because failure to receive an official warning by virtue of not keeping contact details up to date at the Charity Commission is unlikely to be considered a reasonable excuse.

The draft guidance confirms that the Charity Commission will normally give 14 days' notice of an official warning, but there may be exceptional cases where the warning relates to a time specific activity and a shorter notice period is necessary. It also acknowledges that there may be some exceptional cases where the circumstances mean a longer notice period is appropriate.

Charity trustees or a charity in receipt of a notice of an official warning can then make representations to the Charity Commission about the content of the proposed warning. The Charity Commission will normally require representations to be made in writing.

The Charity Commission must consider any representations it receives during the notice period and would take

this opportunity to look again at the circumstances and whether there is any new information that would cause it to reconsider the warning. The draft guidance then states that the Charity Commission will consider if it is still legitimate and justifiable within the facts and circumstances of the case to proceed with the warning. Any representation received within the specified time limit will be considered before the formal warning is issued.

The draft guidance also confirms that the Charity Commission will usually publish an official warning on its website unless it would:

- be detrimental to a particular individual or group of individuals, for example pose a risk to someone's personal safety;
- contravene or prejudice requirements for confidentiality or commercial sensitivity, or risk national security;
- cause severe prejudice to the charity and/or its beneficiaries;
- contravene the Charity Commission's duty to use its resources in the most efficient, effective and economic way; or
- not be in the public interest for any other reason.

Published official warnings will remain on the Charity Commission's website for up to two years after they are first published unless the Charity Commission withdraws the warning before then. Flags will also be placed upon charities' register entries in the same way that the Charity Commission usually flags open statutory enquiries, failure to file reports and accounts on time and reports of completed enquiries and regulatory cases.

The consultation on the draft guidance is open to representations until 23 September 2016.

Concerns have been raised by professional advisers that the creation of this new power may make charity trustees even more risk averse, which will impact innovation. Furthermore, there is no power for charities to appeal a warning to the Charity Tribunal. The power may be used by the Charity Commission in a broad range of circumstances and there are concerns about unreasonable or arbitrary use of the power in response to unjustified stories in the media. The implications of publication could also have a disproportionate impact upon funding and support for charities in receipt of a warning.

We will confirm when the consultation is completed and the final guidance is issued.

Gerry Morrison

The Charity Commission, Cage and funding non-charitable organisations by Charitable Grant Trusts

On 06 May 2016 the Charity Commission published its report on the Joseph Rowntree Charitable Trust (JRCT) and the Roddick Foundation (Roddick) with regards to their providing grants to the controversial human rights advocacy and lobbying organisation Cage (formerly CagePrisoners), following complaints made to the Charity Commission in 2013 concerning the awarding to Cage of a number of grants by JRCT and (later) by Roddick, which amounted to around £300,000 by JRCT and £150,000 by Roddick.

The real issue faced by the Charity Commission (and facing charities) concerns the funding of non-charitable organisations (such as Cage) which undertake a combination of both charitable and non-charitable activities.

The Charity Commission ultimately concluded in this case that *"they could not agree with the charity's assessment that all activities being funded were charitable."* The Commission noted that JRCT had relied on what Cage had reported to the charity about the activities it had been involved in and how they considered that they were using the funds to further JRCT's charitable purposes. The Commission's conclusion was that these reporting requirements were not stringent enough, especially considering that the charity was funding a non-charitable organisation. For example, there were concerns that funds may have been allocated to cover overheads, wages, or any other core costs. This is clearly not using all the funds for the furthering of the charitable purposes.

A number of aspects of the Charity Commission's findings are of note. Firstly, the public policy reasoning behind the investigations is fairly clear and (by and large) non-controversial. It is clear that it is in the public's best interest that funds provided to charities do not ultimately get allocated to

non-charitable purposes. However, whilst the principle is generally agreeable the application of this principle may be a little more difficult to resolve. The burden of proof appears to rest on the side of the charity, with the trustees having a duty to ensure that the funds are properly and lawfully spent. With this in mind, charities must take care to ensure that they keep records and impose controls on any gifts provided to other charities and non-charitable bodies. For example, in allocating the grant a charity would be wise to specify exactly what the funds are to be used for.

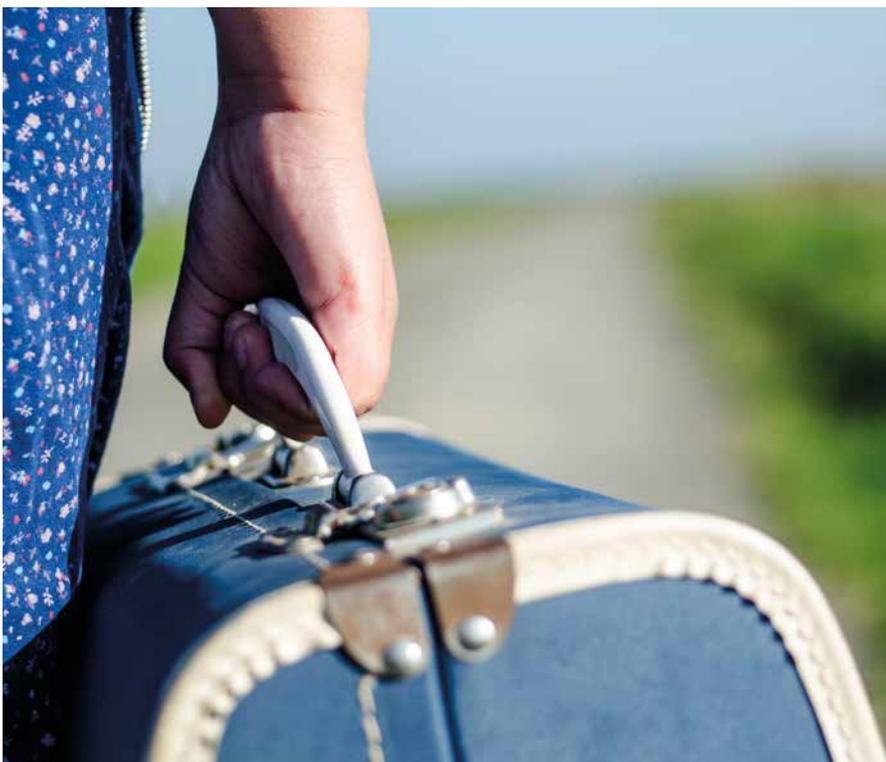
Secondly, there is the slightly amorphous issue of "damage to reputation". JRCT have pointed out that some charities have their reputation as a charity grounded on supporting unpopular causes which are often neglected due to public perception. Charities must be free to support those causes which further their charitable ends. In the new draft guidelines regarding grant funding an organisation which isn't a charity, the Charity Commission states that the trustees should be assured that *"the organisation is suitable for your charity to work with and fund"* and this involves assessing the organisations *"reputation"*. There seems to be a distinct lack of guidance as to what this actually involves.

Following the completion of the Charity Commission investigation in 2014, the Charity Commission requested (and essentially demanded) that JRCT cease funding Cage and, crucially, would grant assurances to the Charity Commission that they would not fund Cage *"in the foreseeable future"*. Initially, JRCT refused to provide such assurances, holding that this would fetter the discretion of the trustees to allocate their grants and the charity should be free to appoint charities to receive its grants based on the current, not past circumstances. The Charity Commission continued to pressure JRCT until JRCT provided the guarantee.

In response, Cage brought a judicial review claim against the Charity Commission saying that it had acted outside of its powers by demanding such guarantees and assurances. The judicial review proceedings were ultimately settled outside court, with the Charity Commission withdrawing its demand for assurances. The result of this, however, is a great deal of uncertainty. Yes, the Charity Commission has stepped back from being able to demand that charities do not apply funds to certain bodies in the future. But the Charity Commission may still investigate charities which it considers are undesirable and fail to further charitable goals, and there is no guidance as to what criteria the Charity Commission will use in deciding on this. The Commission will not fetter the future exercise of trustees fiduciary powers under its general powers to give advice and guidance, but it does not make it clear as to when the Commission will step in when it feels that there has been a transaction with an organisation liable to damage the reputation of charities.

The Charity Commission ultimately acknowledged that the trustees acted in good faith when allocating the funds. What will be interesting, however, is whether good practice in this area will be affected on the implementation of the Charities (Protection and Social Investments) Act 2016 which was passed to give the Charity Commission more "bite" in dealing with mismanagement and misconduct in the running of a charity. Whilst there was clearly no misconduct in this instance, it could be argued that there was mismanagement, especially given that significant funds were allocated to potentially non-charitable purposes. Only time will tell as to how the Commission will use its new powers in such circumstances in the future.

Daniel Forshaw



Brexit – The impact upon charities

For many charities the Brexit outcome has created a great deal of uncertainty.

Short-term

The most immediate short-term concerns for charities are inevitably funding-related:

Charities with investment portfolios may be facing reduced income as markets fall. Charities that are reliant upon income generated by their investments will therefore be closely watching market developments.

Charities funded directly or indirectly from European sources may have terms and conditions that go beyond the date of the Brexit. There is concern about whether European Social Fund backed programmes will continue to run in accordance with published timetables.

Charities involved with the provision of social housing may also be concerned about increased operating and development costs.

Charities with defined benefit pension schemes or legacy defined benefit pension schemes may face increasing deficits resulting in higher employer contributions.

Brexit may also impact upon the definition of "charitable" for UK tax purposes. There may also be implications for charitable tax reliefs in respect of charitable donations made across European borders.

There will, of course, also be implications for employment law which charities employing people will be keeping watch upon and our Employment team is keeping organisations up to date with this.

Longer-term

The NCVO has warned that the greater effects of Brexit on charities will be in the long-term. It is also predicting that the Government will maintain EU regulation for at least the next two years and probably for much longer.

The Information Commissioner's Office has stated that data protection standards will still have to be stringent after Brexit and that rules would have to be equivalent to EU if the UK wanted to trade with the single market. Therefore, it is likely that charities will still be required to observe strict data protection regulations.

Grant making charities that are heavily reliant on investment income may have

less income available for distribution and trustees may have to adjust their grant making policies accordingly.

Charities that are reliant upon income from grant makers (or EU funding) may also wish to consider diversifying their income streams to mitigate risk and plan for uncertainty.

We will keep a close watch on the impact of Brexit and continue to report.

Gerry Morrison



Registers of People with significant control

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Relevant Legal Entities (RLEs)

It is important to note that PSCs can only be natural people. Directors of subsidiaries of charities should bear this in mind when putting together the subsidiary's PSC Register. However, subsidiaries of charities will need to include details of RLEs in their PSC Registers. Charitable companies will also need to consider the make-up of their organisations in respect of whether they have any RLEs.

In the majority of cases a RLE is another company that keeps its own PSC Register and is the parent or directly holds a majority of voting rights in the company. The RLE of a wholly-owned subsidiary of a charitable company would therefore be the charitable parent.

A subsidiary wholly-owned by a charitable company will therefore need to list the charitable company as a RLE.

Confirmation statements

In addition to keeping internal PSC Registers up to date, it will also be necessary to notify Companies House at the time the charitable company's or subsidiary's Annual Return would have been due. Annual Returns have now been replaced by Confirmation Statements which will also need to include PSC information, which will be publicly available on Companies House's Register of Companies.

The new rules are very complex and especially so where these are applied to charities. Nonetheless directors of charitable companies and subsidiaries are required to comply with the above regulations.

It is also important to note that the PSC Register will never be blank at Companies House – If there are no PSCs or RLEs a charitable company should make its statement to Companies House as follows: *The company knows or has reasonable cause to believe that there is no registrable person or registrable legal entity in relation to the company.*

It is likely that charitable companies with large company memberships will not be in a position where they have any PSCs or RLEs. However charitable companies with smaller memberships or with provisions in their Articles of Association allowing individuals or trusts to exercise powers of appointment or removal of directors may have to declare PSCs. Charitable companies' circumstances will also change from time to time meaning that charity trustees should be vigilant to changing circumstances and maintaining the PSC Register. Auditors will also be aware of these issues.

Companies House has powers to issue penalties for non-compliance including criminal prosecution and large fines.

Gerry Morrison

Information

If you have any queries on any issues raised in this newsletter, or any charity matters in general please contact Gerry Morrison on (01482) 625790 or email gerry.morrison@rollits.com

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We hope you have found this newsletter useful. If, however, you do not wish to receive further mailings from us, please write to Pat Coyle, Rollits, Citadel House, 58 High Street, Hull HU1 1QE.

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