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# Charity Law

## Update

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# Charities connected with non-charitable organisations

## Maintaining your charity's separation and independence

The Charity Commission has published draft guidance for trustees of charities that have a long-term close relationship with a connected non-charitable organisation including:

- Trading subsidiaries;
- Commercial businesses; and
- Not for profit organisations or social enterprises

The draft guidance covers situations in which the connection between the charity and the non-charitable organisation is deliberate. This includes intentional connection such as the ownership of shares (e.g. in a trading subsidiary), common personnel, or purposefully having the same or similar name (e.g. by sharing branding etc).

The Charity Commission emphasises that the guidance is also relevant to charities that regularly enter into shorter term relationships with non-charitable third parties. This may include commercial participants or commercial sponsors.

The guidance is in draft format and is currently out to consultation. The Charity Commission is seeking feedback on the draft guidance and the consultation closes at 5pm on 15 May 2018. The draft guidance can be accessed on the Government's website.

The draft guidance also provides a checklist that charities can use in setting up and maintaining close relationships with connected non-charitable organisations.

The purpose of the guidance is to help trustees understand the risks and challenges that such relationships can bring. It sets out The Charity Commission's expectations in respect of how trustees deal with such risks and challenges and how trustees can take steps to mitigate any risks.

### Case reports

The Charity Commission publishes a number of case reports highlighting the range and complexity of issues it has come across in the last two years, including:

- A charity funding research by a non-charitable organisation with political aims;
- Significant commercial benefit to a connected organisation resulting from the charity's operational activity; and
- The importance of distinguishing whether a service is provided by a charity to help its beneficiaries, or by its subsidiary to raise money for the charity.



### Lack of awareness

The Charity Commission acknowledges that in many cases it is a lack of awareness on the part of trustees rather than a deliberate breach of the rules that leads to problems. It is therefore important that trustees read The Charity Commission's guidance and implement it to avoid unexpected issues and consequences including damage to the charity's reputation. Provided relationships with connected non-charitable organisations are managed properly trustees can avoid regulatory engagement or investigation by The Charity Commission.

### Common issues for trustees

The draft guidance highlights some common issues for trustees when managing the charity's connection with non-charitable organisations:

- Providing funding to the non-charitable organisation (which would usually be on arm's length terms);
- Receiving funds from the non-charitable organisation (e.g. are there any reputational issues, what, if anything is being given in return, are the funds being used solely to further the charity's aims?);
- Completed shared projects or delivering services together (e.g. there can be no subsidy by the charity of non-charitable purposes, what is being provided and delivered and by who and how is this documented, reputational issues, management of risk etc) ;
- Involving the non-charitable organisation in fundraising;
- Sharing names, branding and websites (e.g. avoiding confusion about which entity third parties are dealing with);
- Sharing communications;
- Sharing information or data (e.g. identifying and dealing with any data protection implications);
- Sharing premises or staff (e.g. there can be no subsidy by the charity of non-charitable purposes, there should be a cost/shared services agreement etc).

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## Charities connected with non-charitable organisations (continued)

### Checklist of indicators

The Charity Commission also uses the following list of indicators to see if a charity is connected with a non-charitable organisation:

#### Ownership

Does the charity own all or most of any shares in the non-charitable organisation?

#### Membership

Is the non-charitable organisation the sole or significant member of the charity? Or is the charity the sole or significant member of the non-charitable organisation?

#### Appointment

Does the non-charitable organisation have the right to appoint and remove the trustees of the charity?

#### Common personnel

Are there some people who are directors (trustees), senior executives or employees at both the charity and the non-charitable organisation?

#### Identity

Do the charity and the non-charitable organisation purposely share the same or similar name, branding, website, or premises?

#### Funding

Does the non-charitable organisation regularly fund the charity? Or does the charity regularly give or grant investment funding to the non-charitable organisation?

#### Shared projects/initiatives

Do both organisations routinely share projects or initiatives?

#### Shared mission or common goals

Do both organisations work towards common goals or have shared mission?

### Trustees' key duties

Above all the draft guidance emphasises that trustees must not lose sight of their key duties to:

- Ensure the charity is carry is carrying out its purposes for the public benefit;
- Comply with the charity's governing document and the law;
- Act only in the charity's best interests;
- Manage the charity's resources responsibly;
- Act with reasonable care and skill; and
- Ensure the charity is accountable.

Complying with the above duties protects the charity and ensures that the trustees' actions and decisions are always in its best interests and in accordance with their duties.

The Charity Commission emphasises how the above duties and boundaries can become blurred inadvertently, particularly if the charity's resources are being used to support or subsidise the non-charitable organisation. It also emphasises the importance of abiding by the principles of independence and separation, particularly in respect of finances and resources and decision-making. It also emphasises that stakeholders, creditors and the public must be able to identify which entity they are dealing with (e.g. the charity or the non-charitable organisation).

### Political activity

The draft guidance also emphasises that charities must not further non-charitable purposes because charities must have purposes that are exclusively charitable for the public benefit. Trustees must also take particular care where the non-charitable organisation has aims that are political or undertakes political activity to achieve its aims. Whilst charities may legitimately undertake political activity



to directly further their charitable purposes for the public benefit, charities must exercise caution when receiving funding from a non-charitable organisation with political aims or that undertakes political activity.

Charity trustees must also take particular care not to allow the charity's funds to be wrongly applied for non-charitable purposes. The Charity Commission emphasises in its draft guidance that it also "*shares its information with HMRC, which may assess if there is a tax liability on the funds used for non-charitable purposes*".

### Conflicts of interest and conflicts of loyalty

The guidance also emphasises the trustees' duty to avoid conflicts of interest or conflicts of loyalty. This includes situations where:

- A trustee is also a director of the charity's subsidiary;
- Directors or employees of the non-charitable organisation are also trustees of the charity;

- Trustees or persons connected to them own shares in the non-charitable organisation;
- Trustees are personally connected to individuals involved with the non-charitable organisation (which may include the person who founded the charity);
- Trustees support the aims or purposes of the non-charitable organisation (which may be similar to the charity's purposes).

It also emphasises that senior charity employees making recommendations to the trustees could also encounter conflicts of interest or loyalty in the same way as trustees.

Whilst the existence of a conflict of interest or loyalty it itself is not necessarily a problem or "reflect on the integrity of the affected individual", The Charity Commission emphasises that conflicts must be properly identified, disclosed and addressed.

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## Charities connected with non-charitable organisations (continued)

For example there need to be sufficient independent trustees to effectively manage personal interests and loyalties to form a quorum to vote upon and make valid decisions where conflicted trustees are excluded from the decision-making process.

Where it is not possible to effectively manage a conflict of interest or loyalty, The Charity Commission's authorisation must be obtained before any decision is made to ensure that the decision is valid and enforceable and that the trustees have not breached their legal duties.

### Grant funding non-charitable organisations

The draft guidance also provides detailed information about charities grant funding non-charitable organisations to deliver projects that will further the charity's purposes. The draft guidance also considers what trustees must do when considering paying a connected non-charitable organisation to provide services to the charity (e.g. gives the example of a charity running care homes entering into a contract with its subsidiary to provide a catering service at its homes).

It also considers charities investing in non-charitable organisations, completing shared projects or delivering services together and involving non-charitable organisations in fundraising.

### Sharing resources, premises and staff with non-charitable organisations

Many charities share resources, premises and staff with their subsidiaries and the draft guidance also considers what arrangements should be put in place to ensure that this is done on a proper and legal footing.

It emphasises that the charity should be protected through an appropriate agreement or contract covering the terms of the sharing. These are commonly referred to as "cost apportionment" or "shared services" agreements.

### What if things go wrong?

The draft guidance identifies what should be done if things go wrong, including:

- The risk of confusion due to insufficient separation between the charity and the connected non-charitable organisation giving the impression that the charity has a non-charitable purpose or is furthering the connected non-charitable organisation's purposes; and
- The risk that the trustees' decisions and actions are inappropriately influenced by the interests of the connected non-charitable organisation.



Clearly, trustees should take appropriate advice and immediate steps to rectify the issues, working with professional advisors and The Charity Commission if necessary. The Charity Commission acknowledges that honest mistakes can be made and that a lack of awareness on the part of trustees can lead to issues. It is therefore important that trustees familiarise themselves with the issues and take steps to inform and educate new trustees where there are relationships between the charity and connected non-charitable organisations. Trustee training can be useful and also circulating and discussing The Charity Commission's guidance.

### Potential consequences

The consequences if things go wrong can be serious including:

- Trustee liability if the charity suffers loss as a direct result of the trustees' breach of duty;
- Legal consequences including fines or penalties;
- The charity's reputation being harmed, which can cause lasting damage to the charity and, sometimes to charities generally;
- Regulatory intervention by The Charity Commission to investigate concerns or complaints;
- Removal from the Register; and
- HMRC investigation and penalties.

As above, provided the trustees have acted in good faith, the trustees will not necessarily be at risk of personal liability, but The Charity Commission would expect trustees to act promptly to put things right to prevent a recurrence of the same or similar issues.

### Conclusion

It is important for all charities with relationships with trading subsidiaries or other connected non-charitable organisations to take into account the principles in the draft guidance to ensure that the charity's separation and independence is maintained. The trustees must act solely in the charity's best interest at all times in managing the charity's relationships with connected non-charitable organisations and manage conflicts of interest and loyalties.

The guidance is still in draft format and is open for consultation. Therefore, it will probably be revised before the final version is published. However, trustees and senior managers of charities should be advised to read it.

When The Charity Commission has consulted on the draft guidance it will revise the draft guidance and then publish final guidance which can be accessed via its website in the usual way.

We regularly provide advice to charities with trading subsidiaries and in their relationships with connected non-charitable organisations and similar issues. All too often, setting up the subsidiary and incorporating it at Companies House is the easiest part, but the detail of the arrangements and implementing the proper relationship between the parties is often overlooked. We would be happy to discuss through any queries and to assist trustees in implementing the correct principles and relationships between the charity and connected non-charitable organisations.

**Gerry Morrison**



# GDPR takes effect 25 May 2018

## Another reminder to charities that the General Data Protection Regulation (GDPR) comes into force on 25 May 2018.

The overarching objective of the GDPR is the same as The Data Protection Act 1998: to protect individual's personal data. The GDPR applies to all personal data held by charities irrespective of when the data was obtained (e.g. whether it was obtained prior to May 2018 or not).

Charities should therefore consider what personal data they process and on what lawful basis that data is processed and whether it will still be considered lawful post-implementation of GDPR.

Many charities have been preparing for the implementation of GDPR for some time and we covered GDPR and charities in our recent Charities Annual Legal Update. However, if charities are still unsure how to ensure compliance with GDPR and to review their existing policies and procedures we have a free GDPR Factsheet for charities and can also assist with reviewing existing policies and procedures to ensure compliance.

Please contact David White for further information at [david.white@rollits.com](mailto:david.white@rollits.com) or call 01482 337209.

*David White*

## Information

If you have any queries on any issues raised in this newsletter, or any charity matters in general please contact:

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The law is stated as at 14 May 2018.

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