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Not for Profit eNews

June 2023

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Welcome to the latest edition of MHA Not for Profit eNews.

In this edition of eNews, we focus on the second phase of implementation of the Charities Act 2022 ('Phase 2'), collaborating with Charity Law experts BDB Pitmans to detail the most significant changes, regarding permanent endowments, charity land and charity names and workings names.

We also highlight the outcome of the recent tribunal regarding admission to the Yorkshire Agricultural Society's annual Great Yorkshire Show which will be of relevance to any charity charging VAT on tickets to fundraising events.

As ever, if there are any points you wish to discuss further in this issue please do get in touch.

Best Regards,

MHA Not for Profit team

Charities Act 2022 - What should charities expect from the June 2023 implementation phase?

The article below has been produced by Charity Law experts BDB Pitmans.

The second phase of implementation of the Charities Act 2022 (Phase 2) is due to be brought in in June 2023. As for other parts of the Act, the changes are aimed at reducing unnecessary bureaucracy, often using the analogy of removing barnacles from a boat, to help charities save costs and operate more efficiently but with appropriate oversight.

Phase 2 aims to drive changes in 3 main areas:

1. **Permanent Endowment** a revised definition as well as new or amended powers
2. **Charity Land** some clarification and relaxations in the regime applying to disposals and mortgaging
3. **Charity Names and Working Names** some new or revised powers for the Charity Commission

1 Changes for permanent endowment

Phase 2 will introduce some new powers and refine existing statutory powers where a charity has permanent endowment, as defined in the Charities Act 2011 (the 2011 Act). That definition will change, becoming:

> For the purposes of the Act, property is "permanent endowment" if it is subject to a restriction on being expended which distinguishes between income and capital.

This streamlined definition will be closer, but not identical, to the traditional view of permanent endowment, as a fund where only the income can be spent. For the powers in the 2011 Act, it is the statutory definition, not the traditional meaning, which is relevant.

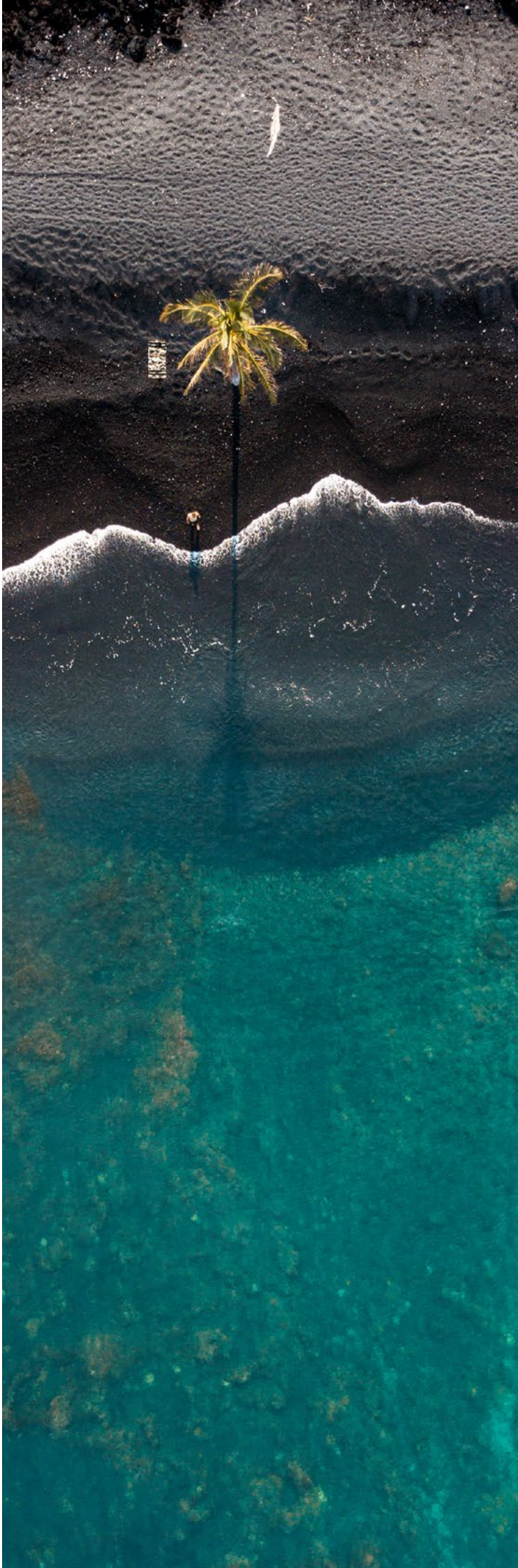
Tweaks to the power to spend capital of permanent endowment

Charities will continue to have statutory power to release restrictions on spending the capital of a permanent endowment fund, where the charity trustees are satisfied that the purposes of the fund could be carried out more effectively if the capital (or relevant portion) could be expended, rather than just the income.

However, the trigger for Charity Commission oversight will change from the current test, which depends upon the origin, income and size of the permanent endowment fund, to a single test of where the "market value" of the fund exceeds £25,000.

The new test ought to be simpler to apply, but will likely mean that use of the power for some funds with a low income will be brought within Commission oversight which currently would not be (although the changed position is probably how the rules were intended to work).

Phase 2 will also make some tweaks to the Commission oversight process, including reducing the period for the Commission to confirm agreement or objection to use of the power from 3 months to 60 days.



A new power to borrow from permanent endowment

Phase 2 will also introduce a new statutory power to borrow from permanent endowment. The new power will be available in addition to any express power available to charity trustees, but can be restricted or excluded by the trusts of a charity.

Broadly, the new statutory power will enable charity trustees to borrow up to 25% of the capital value of the permanent endowment fund, subject to an obligation to repay the capital within 20 years of draw-down.

Importantly, the test for use of the new power to borrow is wider than that for the power to spend the capital of the fund. To use the new power to borrow, the charity trustees will need to be satisfied that it is expedient for the amount to be borrowed in the light of both the purposes of the permanent endowment fund and the purposes of the charity – i.e. the test will allow the trustees to take a more expansive view, perhaps to free up funds for purposes of the charity which may be wider than the purposes of the permanent endowment fund.

There is no requirement for Commission oversight for exercising the new power to borrow from permanent endowment. However, when exercising the power the charity trustees must be satisfied that arrangements are in place for the amount borrowed to be repaid within 20 years. Trustees will be expected to account for their compliance with the repayment plan.

The trustees' obligation under the statutory power is to recoup the capital borrowed. If at any time it appears to them that they will not be able to fulfil the arrangements to repay, or that the arrangements are not sufficient to ensure repayment, the trustees will have a duty to apply to the Commission for directions, which could include allowing longer for repayment, putting in place new repayment arrangements or directing that the amount need not be repaid. On the other hand, where charity trustees' repayment arrangements have gone to plan, they will also be empowered (but not required) to add an amount for capital appreciation where they consider it appropriate to do so.

The Phase 2 changes will also empower trustees who have exercised the power to borrow to decide to release their obligation to repay (by an extension of the existing powers to spend capital), subject to Charity Commission oversight where the market value of the fund exceeds £25,000. To release the obligation to repay, the trustees will need to be satisfied that the purposes of the permanent endowment fund could be carried out more effectively if the obligation ceased to have effect.

In the current economic climate, the new power to borrow from permanent endowment could be very attractive to charity trustees in offering flexibility and a vital lifeline in freeing up funds. Charity trustees considering using the power will, however, have to be mindful of the obligations that come with use of the power, including for implementing and monitoring suitable repayment arrangements.

Total return investment, permanent endowment and social investments

Charities which have a total return approach in place in relation to a permanent endowment fund may be interested in a new power being introduced in Phase 2 to enable the fund to be used to make social investments with an expected negative (or uncertain) financial return. New regulations are due to be published which will govern use of the power.

2 Changes to restrictions on dealing with charity land

Phase 2 will introduce some new powers and refine existing statutory powers where a charity has permanent endowment, as defined in the Charities Act 2011 (the 2011 Act). That definition will change, becoming:

The 2011 Act contains restrictions on dealing with charity land, designed to ensure that charities obtain the best terms reasonably obtainable for disposing of charity land and take sensible precautions before mortgaging charity land. That regime will be retained but some tweaks will be made to it in Phase 2 to bring some more clarity and to make the regime a little easier to apply.

This will include some welcome clarification of the scope of the regime, making clear that it applies only where the interest in land is held solely for or by a single charity, rather than for multiple beneficiaries. For example, if land is held by a charity as one of several tenants in common and the charity is disposing only of its share, that would be in scope (as the only interest is the charity's); but where the charity is one of several tenants in common of land the entirety of which is being disposed of by the trustee of the land, that would not be in scope (as the interest being disposed of is not solely the charity's).

Also welcome will be confirmation that charity trustees, officers and employees can provide advice on a disposal and/or mortgage of charity land, provided they are suitably qualified. Phase 2 will also introduce some more flexibility by widening the category of who can advise on dispositions of charity land (to be termed "designated advisers").

It also aims to streamline the process which charity trustees must go through before making a disposal of charity land by removing the statutory requirement to advertise and also with changes to the prescribed content of the designated adviser's report on the proposed disposition.

Some further tweaks to the regime were originally intended to be introduced in Phase 2, but have been put back to the third implementation due by the end of 2023. This is disappointing (and not obviously in line with the aims of the legislation) as it seems the regime will now be in a state of flux for the next few months.

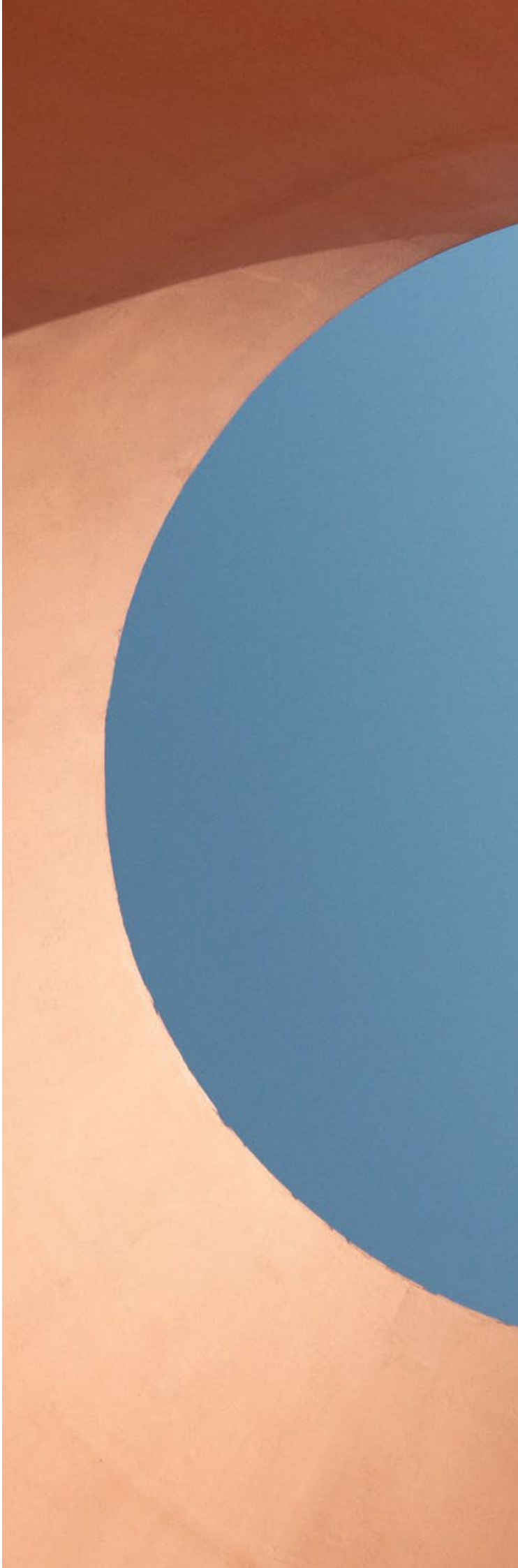
3 Charity Commission powers relating to charity names and working names

Phase 2 will also expand the Charity Commission existing powers to direct charity name changes in certain circumstances.

In particular, Phase 2 will introduce a new power for the Charity Commission to direct a charity to stop using a working name if the Commission considers it too similar to another charity's name or is offensive or misleading. This change was not consulted upon and has not been tested (there has not to date been a definition of "working name" in charity legislation), so it is difficult to gauge how it will work in practice – a charity's working name can be fundamental to its branding and a direction to stop using it could have a very significant impact (e.g. "Comic Relief" is the working name of the charity Charity Projects).

The Commission will also have new powers to delay registration of a charity's new name, and even to delay registration of a charity itself, if it considers the name unsuitable within the terms of the legislation.

Any use of these new powers will need to considered carefully to ensure it is proportionate given the serious impact use of the powers could have on a charity.



Next steps

At the same time as the Phase 2 changes are brought in, we can expect the Charity Commission to publish new and/or updated guidance. That guidance should help charity trustees (and their advisers) negotiate the changes and understand what to expect from the Commission in the use of its new or amended powers under the 2011 Act.

Looking further ahead, a third phase of implementation is expected by the end of 2023. As noted above, it should include further changes to the land disposals and mortgages regime, but is also intended to bring in other provisions, including changes to the powers and processes relating to amending charity constitutions.

In the meantime, charities wishing to make use of the new and updated provisions in Phase 2 should look out for the announcement of implementation in June and start planning now for the new opportunities on offer.

Tribunal success: VAT on fundraising event entrance fees

The outcome of a recent first-tier tribunal regarding admission to the Yorkshire Agricultural Society's annual Great Yorkshire Show sided with the Society, confirming that the Show fell under fundraising exemptions. Whilst an obvious success for the Society, the outcome highlights more generally some important matters regarding VAT and fees for admission to fundraising events.

The Yorkshire Agricultural Society was founded in 1837, primarily to host agricultural shows. For many years they had been including output VAT on the entrance fees charged to attendees. However, after reassessment, the Society believed this approach was incorrect and that the tickets should be exempt from VAT. The Society made a voluntary disclosure to HMRC in April 2020; over £200k had been over declared to HMRC since 2016.

HMRC rejected the voluntary disclose in December 2021 which resulted in the Society taking them to tribunal. The Society's argument was based on the belief that fundraising exemption is available for events organised by charities and other qualifying bodies, with relevant UK legislation stating that the exemption is available for:

> **The supply of goods and services by a charity in connection with an event:**
>
> **a. that is organised for charitable purposes by a charity or jointly by more than one charity,**
>
> **b. whose primary purpose is the raising of money, and**
>
> **c. that is promoted as being primarily for the raising of money.**

The tribunal noted that the UK legislation is too restrictive and must be read in accordance with EU Directive. The tribunal concluded that the word 'primarily' in criteria C above has been incorrectly transposed from EU Directive and should be removed; it was not necessary for the Society to demonstrate that fundraising was the primary purpose of the event.

This judgement has widened the scope of the fundraising exemption which presents an opportunity for charities to further reclaim output VAT associated with fundraising events.

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