

PUTTING THE THIRD SECTOR FIRST

CHARITY LAW UPDATE AUTUMN 09



UNRAVELLING LEGACIES

Legacies are an important part of any charity's income. Generally charities can expect to receive one of three types of legacy:

1. A **specific legacy** – a particular asset such as a house, bank account or shareholding.
2. A **pecuniary legacy** – a specified amount of money.
3. A **residuary bequest** – a share of the whole or a part of the remainder of the estate after all debts, funeral expenses, expenses of administration and legacies have been paid.

Inevitably when dealing with legacies there are some tax considerations which should not be overlooked. There are three taxes to be considered – Inheritance Tax (IHT), Capital Gains Tax (CGT) and Income Tax.

Generally, IHT is not an issue for charities as Section 23 of the Inheritance Tax Act 1984 provides that legacies to charities are exempt. However, charities cannot afford to ignore IHT and should check to make sure that when paying out the estate, Executors have not deducted IHT from the residue before dividing it amongst beneficiaries. If that is done then effectively charities have paid IHT.

IHT being wrongly allocated amongst residuary beneficiaries can lead to a significant reduction in the amount received by a charity.

Charities are also exempt from CGT. It is often assumed by Executors that because residuary beneficiaries are all charities then they do not have to worry about CGT. Unfortunately that is not the case as Executors are themselves tax payers.

For example, if Executors agree a value of a house at £150,000 and subsequently sell the house for £200,000 there will be a capital gain of £50,000. If the house is sold by the Executors a CGT bill of £7,182 will have to be paid. If the house had been appropriated to the charitable beneficiaries first and then sold on their behalf there would be no CGT to pay. This also applies to shares or any other assets which are subject to CGT if they were sold at a gain. Charities should therefore ask Executors to consider appropriating assets to them first before their sale if there is a possibility of a capital gain being realised.

Charities are also exempt from paying Income Tax. It is possible for them to recover Income Tax deducted on income received from the residue of an estate. In order to do so charities should request a Form R185E for each year in which assets are paid to them during the administration of an estate. The Executors are obliged to provide the certificate in terms of Income and Corporation Taxes Act 1988 Section 700(5).

Legacies will no doubt play a more significant part in the income of more and more charities during the current credit crunch. With careful management it is possible to maximise the income received without paying tax so it is vital that accounts received from Executors are checked carefully to make sure that no tax has been paid unnecessarily, or where it has it can be recovered.



THE RISK FACTOR

Is Trustee Indemnity Insurance the answer?



EASY STEPS TO INCORPORATION

Converting your charity to a company



LOOKING AHEAD

Changes afoot in charity law



THE RISK FACTOR

The Scottish Government plans to amend the 2005 Act to allow unincorporated charities to take out Trustee Indemnity Insurance (TII) for their Trustees. TII covers Trustees for claims made against them personally for certain liabilities that they might incur in their capacity as charity Trustees.

WILL TRUSTEE INDEMNITY INSURANCE PROTECT ME?

Check the policy wording carefully. The principal exclusions are criminal fines and the costs of criminal proceedings against a Trustee. Trustees would also not be covered for liabilities arising out of conduct in circumstances which the Trustee knew, or ought to have known, was not in the best interests of the charity. This latter exclusion is open to wide interpretation and should be

discussed with the policy provider prior to taking out TII. TII policies will not normally cover liabilities arising out of contracts entered into by Trustees on behalf of the charity. Examples of matters not covered are redundancy payments, liabilities under a lease and liability for fraud by employees (although other types of insurance can cover these risks).

RISK MANAGEMENT

The decision to purchase TII must be in the best interests of the charity and should not be viewed as a safety buffer for good governance. Trustees should continue to assess all the risks to which the charity is exposed and take adequate steps to minimise that risk, which will not be limited to taking out insurance.



AVOIDING CARELESS CONTRACTS

being locked into contracts for longer than expected, paying more than they envisaged or simply being unable to ensure the supplier delivers the product or service they thought they were getting. Some simple measures can help avoid these problems:

- **Get it in writing** If you don't have any record of what you agreed you'll find it difficult to hold your supplier to it. A written contract signed by you and the supplier is ideal, but even an exchange of emails is better than nothing at all – provided you've retained those emails and can produce them when required.
- **Don't forget the basics** There are only a few things that really matter in the

vast majority of business contracts: who are you?; who are they?; what will be supplied and to what standard or specification?; when will it be done by?; how much will be paid for it and when?; how long will the contract last for? If both sides are clearly agreed on those things and have written them down, it's unlikely they'll fall out later. Most contract disputes have their origins in a failure to properly agree and record the key commercial points of the deal rather than disputes about legal technicalities.

- **Ask for help** Solicitors do good business assisting clients who should have called them before signing the contract rather than after things started to go wrong!



EASY STEPS TO INCORPORATION

Charities can be in many legal forms: some are Trusts and are governed by a Deed of Trust; some are unincorporated organisations and are bound by the rules and ethos of a common understanding and agreement of the members; and some are companies limited by guarantee. There are pros and cons to the choice of legal form but it is important that the correct model is chosen so that your charity is run as effectively as possible.

The most appropriate legal form for charities which employ people or which enter into contracts is that of a company. Companies limited by guarantee offer protection to the Trustees and Members of the charity in two ways.

Firstly, unlike unincorporated organisations, companies have separate “legal personality”, meaning that the company itself can enter into contracts rather than being represented by its chief officers. Should anything go awry

with the contract, then it is the company that is sued. With an unincorporated association, the Trustees must enter into contracts on behalf of the charity and are therefore laying themselves open to being sued personally, with a threat that their personal funds could be attacked if they are the losing party. Members too could be open to this challenge if they ratify the contract.

Secondly, the Members of the company are protected by limited liability. So, if the charitable company is sued for more funds than it has, the Members are only personally liable for however much they guaranteed to pay (usually just £1 in a standard company constitution).

OSCR has a fast track procedure for changing a charity’s legal form, which makes incorporation a simple and faster process for those charities which have a dissolution clause in their present constitution. This involves:

- Approving a new Constitution (the “Memorandum and Articles of Association” – be careful when using styles from other charities as company law rules have changed recently)
- Applying to OSCR for their consent to change in legal form
- Incorporating at Companies House
- Notifying OSCR when incorporation has completed

For those which do not have a power to wind up the charity, the reorganisation procedures must be used. Although this process is less straightforward, we can assist you through the process in order to achieve the protection that your Trustees and Members require.



Life. We're in it together

We have been advising on charity law for over 300 years and pride ourselves on providing a very approachable and professional service.

That's why many charities and not-for-profit organisations continually turn to Gillespie Macandrew for quality, tailor-made services and advice.

We understand the increasing pressure to comply with not only charity law but a raft of business law requirements. We, therefore, have highly qualified experts on hand who can advise on such issues including employment law, commercial contract, property, fundraising projects and lottery schemes.

For more information please contact our Head of Charities Partner, Tom Murray on:
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LOOKING AHEAD

Two significant documents have been published, both of which could impact the charity sector in Scotland.

CALMAN COMMISSION REPORT

The Calman Commission report recommends that there should be a single definition of each of the expressions “charity” and “charitable purposes” throughout the United Kingdom. This would mean that OSCR would use the same charity test as HMRC and the English Charity Commission, thus getting round the problem that currently exists where there could be bodies who pass the Scottish Charity Test but who do not receive tax relief from HMRC.

The report also recommends that charities which are registered in one part of the United Kingdom should be able to conduct their activities in other parts of the United Kingdom without being required either to register or report there separately.

In our view, both of these recommendations should be welcomed by the charity sector as a whole.

The Calman Commission also recommend that certain Income Tax raising functions should be transferred to the Scottish Government. Potentially, this could pose a significant threat to the charity sector in Scotland as it could severely impact and reduce the amount of income the charities receive if Gift Aid regulations are not the same across the United Kingdom.

SCOTTISH GOVERNMENT CONSULTATION

The Scottish Government Consultation Paper makes a number of suggestions

for amending the 2005 Act including granting OSCR further powers to appoint new Trustees to charities and to re-organise charities administrative provisions.

The Consultation also suggests that the law should be changed so that all Scottish charities formed prior to 2005 which refer to ‘Charitable Purposes’ prior to that date, should be deemed to pass the charity test. Our preference would be to follow the Calman Report proposal and have a single test on both sides of the border. The Scottish Government’s proposal does not go far enough and does nothing to help United Kingdom charities who use the HMRC definition who are trying to be entered on the Scottish Charity Register.

The Report also considers, but is not in favour of, adopting the English system whereby smaller charities do not need to lodge Annual Accounts and Returns with OSCR (charities with incomes of under £25,000 per annum) and very small charities with incomes of under £5,000 per annum do not need to register with OSCR. This means that, going forward, smaller Scottish charities will continue to face a significantly greater regulatory burden than their English equivalents.

It also means that OSCR’s limited resources will continue to be overstretched dealing with compliance by small charities meaning that delays in setting up new charities will continue and the real risks posed by substantial charities with significant public donations, will not get the attention they deserve.



TOM MURRAY
(HEAD OF CHARITIES TEAM)

Tom Murray has a wealth of knowledge and experience on legal issues facing Charities and NGOs today. His advice is sought both by an increasing charity client base from both sides of the border and also by other firms of solicitors seeking specialist advice. Tom regularly lectures on the subject both here in Scotland and in London. He is Chairman of the British Hallmarking Council and a Director of Mercy Corps.



CHRISTIAN MELVILLE
(PARTNER)

Christian Melville continues to grow his charity practice. His instructions remain diverse and range from Macmillan Cancer Support to the Regimental Trust of the Royal Scots Dragoon Guards. Christian is currently engaged in advising charity clients from North and South of the Border on all aspects of the new regulatory regime in Scotland, and how best to approach, pragmatically, the demands of OSCR.



JOHN McARTHUR
(PARTNER)

John McArthur has advised Charities on their structure, administration and on taxation matters for almost 20 years. He is a qualified lawyer but also a member of the Chartered Institute of Taxation and advises some of the countries largest charities. He also has day to day practical experience in the financial administration of Charities as the Treasurer of a Charity with a turnover in excess of £1.5m.