

## Charities & Education

# update

## MERGERS – ARE THEY THE ANSWER?



Mike Farwell

**There has been an increasing trend in recent years for charities to merge or work in a more collaborative way with other charities.**

One of the obstacles to charity mergers in the past has been the problem of future legacies left to the 'old' charity – the Charities Act 2006 simplified the process as charities can now register with the Charity Commission so that any future legacies can be applied to the successor charity.

But what other things should trustees consider when they are considering a merger?

In the first instance, trustees will need to check that they have legal authority to proceed, either through their governing document or from the Charity Commission. They will also need to ensure that there is enough similarity of purpose and structure between the two charities.

The main issues to consider when investigating a merger include:

- whether the merger is in the beneficiaries' interests
- addressing legal issues
- assessment of employment issues such as TUPE, pensions liabilities and compliance with employment law
- handling staffing issues, particularly where this involves redundancies
- assessing risks, including operational and reputational risks

The stages in the planning process for a merger normally include:

- joint explorations of key issues, benefits, obstacles
- initial feasibility study, cost benefit analysis, risk assessment
- appointment of a project manager/team
- legal/accounting assessment – consider need for Charity Commission advice
- formal due diligence
- formal decision by trustee body to proceed

Due diligence is an important part of the process to ensure the organisation has full knowledge of the charity they plan to merge with and that there are no post-merger surprises.

Due diligence is likely to include commercial, financial and legal matters. The exercise should help build trust during the merger negotiations and ensure that any problems are addressed at an early stage, thereby enhancing the potential for a successful merger.

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## Public benefit update

The Charity Commission has now issued public benefit guidance for charities. The basic principles require there to be an identifiable benefit, and the benefit must be to the public, or a section of the public. The guidance also explains how the Commission will assess the public benefit of individual charities and how charities are required to demonstrate and report on their public benefit. It is expected that the provisions will come into force in March 2008.

It is anticipated that draft supplementary guidance

for consultation on the public benefit of specific types of charity will be issued in February 2008, with consultations set up for charities to advance religion or education, or to relieve poverty, or for those that charge fees.

Charities will be required to report on public benefit as part of their accounts from March 2009.

**Further information can be found on the Charity Commission website [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)**

## House of Lords' cash boost for charities

Many charities could now be entitled to substantial repayments of VAT accounted for or incurred in the years from 1973 to 1996/97.

It follows the victory of the taxpayer in a war with HMRC that has raged for over ten years. In late 1996 HMRC introduced a three-year time limit for claims for over-paid VAT. A few months later they extended this to back claims for input tax. In neither case did they ease the pain by way of a transitional period.

This has led to a great deal of litigation and on 23 January 2008 the House of Lords found in favour of the taxpayer. As a result, HMRC faces a bill for late claimed VAT and interest that almost certainly exceeds £100m, especially if they agree to pay interest on a compound basis.

Among those claiming are a number of James Cowper charity clients.

There is still time to make or resubmit claims for VAT over-paid prior to 4 December 1996 or under-claimed prior to 1 May 1997 although time will now be running out. A six month guillotine is likely to be introduced for any new claims in relation to those periods.

Charities should now review their VAT affairs to see whether they or their trading subsidiaries could be affected. Possible areas where there may be opportunities include:

- Hospitals, especially where their activities include the installation of prostheses
- Charities running cultural facilities
- Charities organising foreign travel

This list is by no means exhaustive. Charities that would like help with carrying out a review or with submitting a claim should contact Terry Dockley on +44 (0) 1635 35255 or [tdockley@jamescowper.co.uk](mailto:tdockley@jamescowper.co.uk)



Penelope Lang

# New Rules For Substantial Donors

**Changes to legislation on substantial donors have important implications for charities.**

HM Revenue & Customs (HMRC) has introduced this legislation as a result of various tax avoidance schemes which involved the use of charities to obtain tax relief primarily through Gift Aid (relievable gift) at the same time as the donor receiving a benefit from the charity. HMRC's website gives numerous examples of how the new legislation works.

HMRC did not feel the required element of philanthropy was present in these transactions.

A substantial donor is someone who makes a relievable gift of at least £25,000 in a period of 12 months or makes a gift of £100,000 over six years.

Broadly if the substantial donor, or anyone connected with him, is involved in a transaction with the charity in the next six years, the charity will be caught by the new legislation. Where the substantial donor has made gifts in excess of £100,000 over six years, the period under consideration can be as long as 14 years.

If the charity enters into a transaction with the substantial donor, a connected person such as a relative or a company with which the donor is involved, the charity may be taxed on the amount paid to the substantial donor. The charity will be taxed as though it has made non-charitable expenditure.

One example relates to a charity giving grants to the homeless. It makes a grant of £300 to a homeless man in February 2008. In March 2009, he receives a legacy and gives £30,000 to the charity. The original grant becomes non-charitable expenditure and thus subject to tax. Other examples relate to land. An individual is a substantial donor, and some five years later, the charity has a building to let. He is the only person who wants to take the lease, but if he does, all of the rent will be treated as non-charitable expenditure, even if it is a full market rent.

In order to ensure that a charity does not fall foul of these new rules, the charity must keep detailed records of all donors. HMRC says, rather comfortably, that not many donors will fall within the new rules, but of course should someone become a substantial donor under the six year £100,000 rule, then the charity has to look back six years as well as forward. The charity also has a duty to keep records of transactions with persons connected with the substantial donor, such as spouses, brothers, sisters and other family members.

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## CHARITIES SORP

The Charity Commission and the relevant accounting standard setting body have issued an information sheet as part of their current review of the Charities SORP. The sheet provides non-binding guidance on the interpretation of the existing SORP.

This includes:

- performance related and other grants for specific charitable purposes
- disclosure exemptions for grant making trusts
- costs of loan financing
- the SORP and company law reporting

The information sheet can be accessed on [www.charity-commission.gov.uk/investigationsorp/infosheet1.asp](http://www.charity-commission.gov.uk/investigationsorp/infosheet1.asp) or contact Mike Farwell on +44 (0) 118 959 0261 or [mfarwell@jamescowper.co.uk](mailto:mfarwell@jamescowper.co.uk)

## COMPANIES ACT AND CHARITIES ACT UPDATE

The Companies Act 2006 introduced major revisions in company law and therefore impacts on charitable companies. Like the Charities Act, the Companies Act is being implemented in stages.

As charitable companies are subject to dual regulation they need to balance the requirements of company and charity legislation. As an example, it might not be appropriate for a charity to take advantage of the deregulation provisions in the Companies Act as this may cause transparency and accountability problems.

One of the key sections of the Companies Act covers directors' duties. This includes provisions covering such matters as exercising reasonable care, skill and due diligence and acting in good faith to promote the success of the company. A recent ministerial statement clarified that success means the attainment of the objectives for which the charitable company was established. It may be prudent for charitable companies to review their objects to ensure these are sufficiently clear to allow the directors to demonstrate that they are achieving them.

The Charities Act creates a new vehicle known as the Charitable Incorporated Organisation (CIO). This will have the benefit of a corporate structure such as reduced liability for trustees, but without dual regulation.

Creating CIOs will require additional legislation and it is expected that the new framework will come into force in 2008.

CIOs will have a number of benefits:

- single registration
- less onerous accounting and reporting requirements
- simpler and more flexible constitutional arrangements
- more straightforward merger arrangements

It is anticipated that there will be a relatively easy process for converting existing charities to CIOs.

## Gift Aid

Responses to the Gift Aid consultation programme were published in December 2007 and can be accessed through the HM Treasury website. Changes to the Gift Aid system are likely to be announced in the 2008 Budget – the stated objective is to 'explore ways to increase the take up of Gift Aid'. [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

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