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Charities & Not for Profit newsletter

Charity Commission cases



Grangewood Educational Association

This charity ran a primary school in London and in 2018 the Commission was receiving various documents claiming that the charity was financially unstable; the sole trustee had been acting inappropriately; and that parents had been unexpectedly advised that the school was closing. There was only one trustee following the death of another and resignation of a third.

The sole remaining trustee advised parents that the school would be closed which understandably worried the parents.

The inquiry looked into the following matters:

- the financial control and management of the charity
- whether the trustees had acted in accordance with the charity's governing document
- whether conflicts of interest had been adequately managed
- whether transactions with trustees had been properly authorised
- whether due care had been taken in making decisions about the future of the school
- whether the trustees had complied with the requirements of the Charity's Act when disposing of the charity property in 2015.

The Commission appointed interim managers to allow the pupils continuity of education to the end of the academic year and the trustee subsequently stepped down.

The school continues to operate under new management.

The inquiry heard from the sole trustee who admitted that they did not have a proper

understanding of the legal and financial responsibilities of a trustee and had not been fully aware of the importance of their trustee role.

Issues for the wider sector:

- all decisions must be quorate (the charity needed a quorum of 3 but decisions were made by a single person)
- a lack of knowledge of regulation and charity law is no defence for failure to comply
- all charities must have an effective trustee body to protect assets and to control and administer the charity in accordance with its governing document, charity law and Commission guidance
- public confidence depends on the conduct of trustees, how they safeguard charity funds and undertake the objects and activities of the charity
- if a trustee body is unable to undertake obligations themselves they must make sure appropriate advice is sought and followed
- all annual submissions (the annual report, annual return and annual accounts) must be made to the Commission
- trustees need to be aware that rules relating to trustee expenses are more stringent than those for corporate bodies

Future Vision Consortium

The Charity Commission (CC) has recently concluded an investigation into Future Vision Consortium. Future Vision Consortium was a Charity first registered in 2013, but following a Commission investigation was removed from the register of charities in June 2019 on the grounds that it did not operate.

The charitable objects were to relieve poverty,

sickness and distress and to advance education for the public in the UK and Somalia and in particular to provide grants, advocacy, information, advice and translation services in furtherance of those objects. The charity had been a "double defaulter" because it had failed to submit accounts and an annual return for 2015 and 2016. The Commission was only able to contact one of five charity trustees who advised that the charity was inactive, had lost all its records in an office move and had no bank account.

The charity had links to a company called Future Vision Care and the only bank account disclosed by the charity was that of the company. The company's financial figures had been uploaded to the Commission website in place of the charity's

own figures. The charity itself had no income or expenditure.

Lessons for the wider charity sector:

It is a legal requirement if a charity ceases to exist or no longer operates, to advise the Charity Commission. Any charity with income over £5,000, and all CIOs must register with the Commission.

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Charity Commission comments on quality of external scrutiny

In August 2019 the Commission published a study reviewing the quality of external scrutiny (audits and independent examinations) reports.

A sample of 296 sets of charity accounts were compared to a Commission benchmark to see whether a minimum standard is being met. The auditors and independent examiners involved in below par reporting have been contacted by the Commission.

There are around 64,000 registered charities with income over £25,000 that require external scrutiny. 76% of audited accounts were satisfactory and met the benchmark, with the percentage being lower for those requiring an independent examination.

In some cases, especially those with smaller incomes being independently examined by unqualified individuals, the three compulsory components of the financial statements were not all submitted. In all cases when income is over £25,000, a charity must submit a trustees' report, an external scrutiny report (audit or independent examination) and the accounts.

Only 37% of charities with income of £25,000 -

£250,000 submitted three satisfactory documents, with some submitting minutes of trustees' meetings or a Chair's report instead of the trustees' report. Some external scrutiny reports were missing or made incorrect references to the now repealed 1993 Charities Act. In one instance one of the trustees acted as the independent examiner, which is a clear breach of the duties of both a trustee and an examiner.

An issue concerning the Commission when looking at the accounts was that of trustee related party transactions and conflicts of interest, with incomplete disclosure in the accounts suggesting potential failures to report issues arising. This is covered in a separate article in this newsletter.

The Commission makes it clear that for a charitable company, it is not possible to submit micro-entity accounts, abbreviated accounts or abridged accounts.

Another requirement specific to charitable companies is the inclusion of a separate Income & Expenditure account or a clear indication that this statement is included within the Statement of Financial Activities.

Gift Aid - are you maximising claims on fundraising activities?

Charities hold a variety of events to raise funds. It is vital to know whether Gift Aid can be claimed on donations received from these events, otherwise claims could be missed or made on ineligible donations. Below are some of the more common fundraising activities and tips on how to maximise Gift Aid claims for these events. The focus is on the donor benefit rules, but the other Gift Aid requirements, such as receiving a valid declaration, will still need to be met.

Charity Auctions

Auction bids can attract Gift Aid in some circumstances. Generally, payments for items at charity auctions are purchases and not gifts. However, bidders often intentionally pay over the odds for an item so that the charity can receive a benefit. For a payment, or part of it, to be eligible for Gift Aid it is important that the donor benefit thresholds are adhered to. As a reminder, the current donor benefit thresholds are 25% of the donation for gifts of up to £100, then 5% of the donation on the amount above £100, up to a maximum benefit of £2,500.

If the item is commercially available, the benefit for Gift Aid purposes is the market value of the item. However, if it has been increased in value, e.g. signed by a celebrity, or is an item which is not commercially available, the benefit is the amount of the auction bid, so Gift Aid is not available.

If an item's auction price compared to market value

mean that the benefit rules are not breached, the excess over the market value can be treated as a Gift Aid donation. The donor must know the market price at the time of bidding, so they know they are paying an excess as a donation, and the same item must be available to purchase elsewhere.

For auctions of promises, generally the services will not be commercially available. However, there are exceptions, such as a local business offering their services for free, so the market value of the promise can be easily ascertained.

Charity events

Many charities hold dinners or similar events to raise funds, by charging for attendance and also collecting donations at the event. If there is a set ticket price or minimum donation to attend then this is not a gift. However, if there is a ticket price plus a suggested donation, this enables Gift Aid to be claimed on the donation element. It must be clear that the right to attend is available even if no donation is made and no special treatment is given to those making the extra donation.

For example, a charity puts on a concert to raise £2,000, the cost being £5,000. By inviting 100 people, the receipt from each attendee needs to be £70 to achieve their goal. Rather than setting £70 as the ticket price, they charge £60 for attendance with a £10 suggested donation. The £10 would be eligible for Gift Aid but if donations are not received the charity still covers its costs and raises additional funds.

If no ticket price were charged this could put the charity's own funds at risk, which could cause tax and governance issues.

Sponsored Challenge Events

Challenge events, such as parachute jumps and treks, are a fun way to raise funds and generate publicity. Usually, participants pay a registration fee and have a sponsorship target. The charity pays for the cost of the event.

Sponsorship payments from individuals not connected with the participant can qualify for Gift Aid. However, whether payments from family members (spouse/civil partner, children, grandchildren, parents, grandparents and siblings and the spouses/civil partners of these) qualify for Gift Aid depends on the donor benefit rules.

A participant is receiving a benefit equal to the cost of the event, less any payment they personally make towards the cost. Where the value of the benefit exceeds the donor benefit thresholds, Gift Aid will not be available on sponsorships payments from the participant or their family members.

If they pay the full cost of the event then the benefit is nil and Gift Aid can be claimed on all donations but not the payment to meet costs.

It is difficult for a charity to know the relationships between participants and those sponsoring them so on the event documentation and sponsorship form the rules as described above should be outlined, together with a definition of who would be connected with participants.

By taking the above into account charities can maximise Gift Aid claims for these types of events.

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Charity Commission - updated guidance (CC23)

The Commission has published updated guidance for Exempt Charities (CC23).

An exempt charity has charitable status but cannot register with the Charity Commission (CC) and is not directly regulated by the CC but instead has another principal regulator. It is possible however for another regulator to ask the CC to investigate an exempt charity under a memorandum of understanding between the CC and each of the principal regulators.

The CC can also provide advice to exempt charities, after consultation with the other regulator, on matters such as trustee conflicts of interest and ex gratia payments.

The responsibilities of a trustee for an exempt charity are no different to those for a registered charity, and much of charity law is also relevant, including the requirement to produce proper accounts.

Exempt charities include educational charities such as universities and academies, certain museums/galleries, charitable benefit societies and friendly societies and Church of England and Methodist Church investment funds.

The updated guidance gives information about which body is the principal regulator for each type of exempt charity.

Disclosure & barring service update

As from 1 October 2019, the basic fees charged by the Disclosure and Barring Service (DBS) will be reduced as follows:

- Basic DBS check to £23 from £25
- Standard DBS check to £23 from £26
- Enhanced DBS check to £40 from £44

The charge for the update service will remain at £13 per year and a standard or enhanced volunteer application will still be free of charge.

Charity Commission comments on reporting related party transactions

Charities preparing their accounts in accordance with the charity SORP must disclose:

- trustees' remuneration and expenses
- trustees' expenses
- transactions with entities and individuals closely connected with the charity and its trustees; or
- if none of these transactions exist, this must also be stated

The accounts (a sample total of 262) were reviewed depending on whether the charity's income was £25,000 - £250,000 (requiring an independent examination which does not have to be by a qualified person), £250,000 - £1 million (requiring an independent examination by a qualified person) or over £1 million (requiring a mandatory audit). Generally speaking the higher the income the better the disclosures. A recurring error in smaller charity accounts was neglecting to make a statement saying that there were no related party transactions when that was the case.

Of the sampled accounts, 77 did not give adequate disclosure of related party transactions and in none of these cases had the auditor/independent examiner made a report to the Commission. In some cases, the Commission assumed that a nil statement was merely omitted in error.

However that was not the case in all circumstances and the Commission is concerned that a lack of disclosure in scrutinised accounts could mean that the auditor or independent examiner may have been complicit in the failure.

Issues for the wider sector include:

- improving the transparency of related party transactions
- ensuring that trustees are aware that even though they may delegate accounts preparation to staff or external accountants, the responsibility still lies with the trustees.
- the auditor or independent examiner cannot be expected to know all related party transactions unless the trustees disclose them openly.

This follows through to the management of conflicts of interest, where the Commission is concerned that there may also be under-reporting. Trustees must take a rigorous approach to identifying and managing conflicts of interest by:

- not putting themselves in a position whereby duty to the charity conflicts with personal interests/loyalty.
- not receiving any benefit (personally or to connected parties) from the charity unless it is properly authorised and is in the best interest of the charity

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Impact of CJEU decision on the treatment of VAT on Management Investment Fees

There have been two recent judgements, one from the CJEU and one from the Supreme Court, which may be of great significance for any charity which seeks to recover VAT on a proportion of its costs relating to fundraising.

The University of Cambridge case concerned whether the VAT on management investment fees incurred by the University in relation to its investment portfolio could be treated as an overhead of the business and therefore partially recoverable. The University's argument was that the income from endowments and donations was used in every aspect of its activities. The University won at both the First Tier Tribunal and Upper Tribunal. The Court of Appeal referred the case to the CJEU. The CJEU has now ruled in favour of HMRC making it inevitable that the Court of Appeal will find for HMRC.

The CJEU gave two reasons as to why the VAT could not be treated as an overhead:

1. The VAT incurred in respect of the management investment fees was directly linked to the non-business activity of collecting donations and endowments and thus could not be recovered.
2. The income from the endowments was used by the University to finance all its activities and the costs couldn't be seen to be components of the University's outputs. As there was no direct and immediate link between the management investment costs and the activities of the University of Cambridge as a whole, none of the VAT could be recovered.

The Court of Appeal has yet to make its ruling as a result of the CJEU decision nor has HMRC released updated guidance. Nevertheless, the immediate impact of the case is that HMRC is likely to seek a clawback of any input tax claimed in respect of investment management fees where there isn't a direct and immediate link with taxable supplies.

In addition, there has also been a concern that because of the second point made by the CJEU above, the case could have a wider impact on charities. It is feared that HMRC could seek to argue that where VAT incurred on general fundraising costs is not a cost component of particular business activities, it is not an overhead of the business. Ever since the UK courts' decision in Church of England Children's Society it has been assumed that VAT on

such costs is an overhead of the general activities of the charity so long as the funds raised are used to support the making of taxable supplies. If HMRC can show that the income from fundraising is used to subsidise all activities, they may be able to use the University of Cambridge decision to refuse the recovery of any input tax related to general fundraising costs.

There may however be grounds of optimism due to the recent Supreme Court decision in the Frank Smart Ltd case. An Aberdeenshire business claimed repayment of VAT amounting to £1,054,852 which was paid on its purchase of 34,477 units of Single Farm Payment Entitlements ('SFPEs'). The critical question in the appeal was whether the SFPE units were to be used for

the purposes of the taxpayer's taxable business supplies. HMRC argued that the VAT incurred on the purchase of SFPEs had a direct and immediate link to the outside the scope of VAT subsidies which the taxpayer earned as a result. The court rejected HMRC's argument, relying on CJEU case law. While all parties agreed that subsidies were outside the scope of VAT, the key test was how the income from those subsidies was to be used. In Frank Smart Ltd's case, the income was invested in its taxable farming activities and thus the VAT was recoverable.

The Supreme Court accepted that fundraising costs can be treated as an overhead of the business. However, they made it clear that the taxpayer won because there was direct and immediate link between the VAT incurred and the company's taxable activities.

The Supreme Court considered the University of Cambridge case and said that the CJEU ruling that income was used to reduce the costs of the University's goods and services prevented the fund managers' fees from being a component of the costs of those goods and services and thus part of the University's overheads.

However, the Supreme Court gave some helpful pointers based on other CJEU cases which may be of benefit to charities. They said that the recognition that fundraising costs may, where the evidence permits, be treated as general overheads of a taxable person's business means that the taxable person must be able to provide objective evidence to support the connection between the fundraising transaction and its proposed economic activities. The taxpayer also needs to maintain adequate banking arrangements and records to evidence the later use of the funds so raised to demonstrate its entitlement to deduct and to retain the deduction.

Charities who have recovered VAT on investment management fees should be prepared to repay that VAT back to HMRC. In terms of the impact of the CJEU decision in the University of Cambridge case, it is too early to tell. The Frank Smart Ltd decision provides hope that charities may be able to develop a strategy to provide evidence of the link between the fundraising costs and taxable activities.

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International Fraud Awareness week

The week commencing Monday 21 October 2019 is International Charity Fraud Awareness week. The Charity Commission aims to raise awareness of the key risks affecting the sector, promote and share good counter-fraud practices and promote honesty and openness about fraud.

In a time when fraud and cyber-crime are on the rise, the Commission is keen for charities of all shapes and sizes to protect their income and assets by building strong defences. The campaign will be led by a coalition of 40 charities and other bodies worldwide.

Go to the Fraud Advisory Panel's website which can be accessed [here](#), to access a wealth of information. There you can download a supporter's pack in the "How to get involved" section and review the e-learning resources, help sheets and publications available in the "Resources" section.

At the launch event on Monday 21 October a new Charity Fraud Awareness Hub will be launched and you can access a link to this via the Fraud Advisory Panel's website in the "How to get involved" section. This new Hub is intended to be a free online area providing guidance, information and case studies to help charities combat fraud globally.

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