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Charities & Not for Profit newsletter

Welcome

By the time most of you read this article, the results of the General Election will be known and, hopefully, we will have some clarity and certainty as to where the country is heading. Nevertheless 2020 is likely to be a challenging year for many.

This edition includes a range of articles which we hope you will find interesting and relevant. The Charities team at PEM remains strong and most of them will be familiar to you. As ever we aim to keep you informed on sector developments as they arise and help you navigate its complexities.

From everyone at PEM, Merry Christmas and a very Happy New Year.

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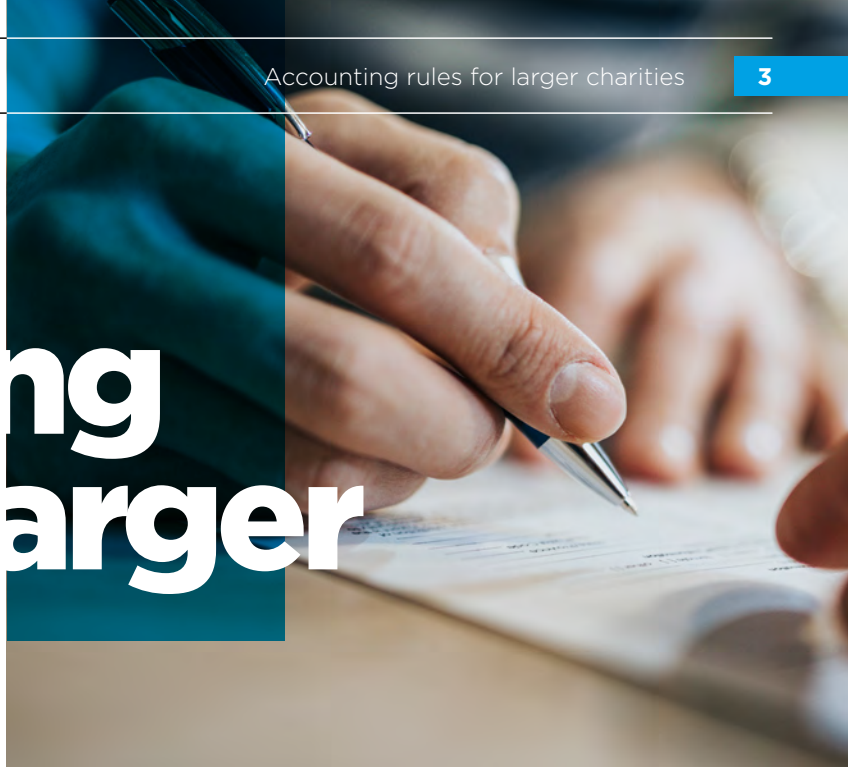

Accounting rules for larger charities

From next year (reporting periods beginning on or after 1 January 2019) charitable companies who qualify as large companies will need to include extra details about their activities in the financial statements as a result of changes to the Companies Act.

Regulators behind the Statement Of Recommended Practice (SORP) have published Information Sheet Three to explain the changes.

Two of the changes apply to charities with over £36m in gross annual income, gross assets over £18m or more than 250 employees and the third applies to all charities with over 250 employees.

The new requirements look at the duties of directors to promote the charity's purpose, as well as stakeholder engagements and employee arrangements.

Duties of Directors - a new reporting statement should be included in the trustees' annual report to testify their duties promote the charity's purpose.

Stakeholder engagements - directors must explain how they have engaged with stakeholders.

Employee engagements – for charities with over 250 employees a statement must be included in the accounts to explain how directors have engaged with employees. Employee' rewards or incentive schemes should also be considered.

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Charity Governance Code consultation

A new consultation has been launched on the Charity Governance Code. The code, which aims to promote good governance was last published in Summer 2017. The consultation which is open until 28 February 2020 is part of the organisation's triennial review policy to ensure the Code remains current.

The steering group are proposing a 'light refresh' of the Code next year with more far-ranging changes taking place in 2023. In addition to the refresh there are plans to develop a 'route map'; this will set out suggested changes that merit a more in-depth revision in 2023.

New structures and buildings allowance

Structures and Buildings Allowance – why is this relevant for charities?

The new structures and buildings allowance (SBA) is a tax relief for expenditure on construction contracts signed on or after 29 October 2018. Whilst the relief itself will generally not be available to charities that don't ordinarily pay tax on their income, calculating the SBAs available on a property and retaining appropriate documentation could increase the property value if sold. This is because a tax paying purchaser will be able to take a tax deduction for any SBAs remaining.

How the relief works

If a taxpayer constructs a new building or renovates an existing non-residential building on land it owns then they are eligible for an allowance of 2% of the qualifying expenditure each year, so relief is obtained over 50 years. The deduction will be taken from the relevant taxable activity that the building is used for (e.g. from trading income or commercial property income).

Non-tax paying charities will not be able to claim any allowances for their period of ownership, but they will be able to pass on the qualifying spend to future purchasers. However, the 50-year clock will not reset, so a building sold by a charity 20 years after it was first brought into use will entitle the purchaser to only 30 years of SBAs.

Qualifying expenditure

SBAs are only available on the cost of constructing or renovating a building or structure. The purchase of land and its alteration (other than so as to create a structure) are excluded, as are planning fees. Where repairs to a building are incidental to a renovation, these can also be included for SBAs.

Capital allowances, as a separate relief from SBAs, are available on certain "integral features" included in building works. Such items are excluded from SBA qualifying expenditure, but as with SBAs, capital allowances may be valuable to future buyers, so it is important that the relevant information is obtained in the first instance.

The allowance statement

Taxpayers wishing to claim SBAs must keep an allowance statement. This is a record detailing all the costs eligible for SBAs and how the property has been used. Purchasers will need to obtain an allowance statement from the seller if they want to claim SBAs in the future. The Commercial Property Standard Enquiries (CPSE) questions have been amended to reflect the need for information about SBAs, so vendors can expect future purchasers to ask for details about whether SBAs are available and if an allowance statement can be provided to them.

Charities that fail to prepare an allowance statement on the completion of a building may find that on sale, their buildings are worth less than they expected and are less attractive to a taxpaying purchaser.

In order to ensure that all qualifying expenditure is included it is advisable to conduct a review of the SBA position as soon as possible after construction or a refurbishment is completed. PEM can assist in identifying qualifying expenditure and preparing the allowance statement.

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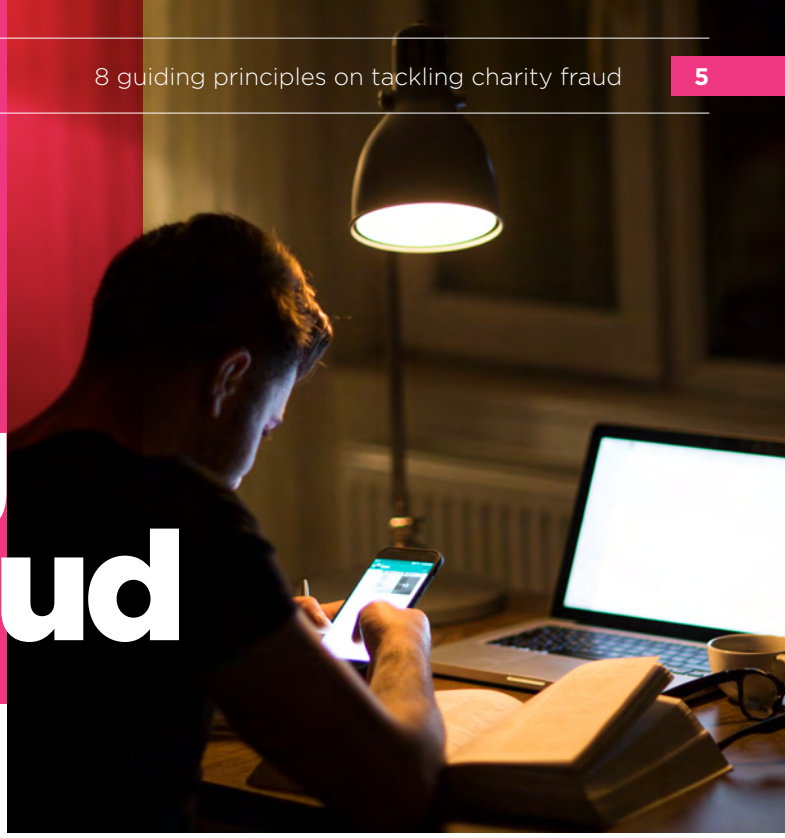
8 guiding principles on tackling charity fraud



A recent publication by the Charity Commission sets out the 8 guiding principles for tackling charity fraud:

1. **Fraud will always happen** – charities are no less likely to be targeted than organisations in the private or public sector. Even the best prepared organisations cannot prevent all fraud.

2. **Fraud threats change constantly** - due to digital technology fraud envolves continually. It is important Charities can adapt their defences quickly and appropriately.

3. **Prevention is key** – effective prevention can reduce financial loss and reputational damage. Prevention is more cost effective than to remedy any damage caused by actual fraud.

4. **Trust is exploited by fraudsters** – Charities should develop a strong counter-fraud culture to encourage the robust use of fraud prevention controls and a willingness to challenge unusual activities and behaviour.

5. **Discovering fraud is positive** – Charities should talk openly and honestly about fraud – to fight fraud it needs to be found.

6. **Reporting fraud** – timely reporting of fraud to police and regulators is fundamental to strengthening the resilience of individual charities and the wider charity sector.

7. **Proportionate anti-fraud responses** – the first step to fighting fraud is to implement robust financial controls which everyone in the charity works with. However, these responses should be proportionate to the charity' s size, activities and fraud risk.

8. **Everyone should fight fraud** – everyone in an organisation has a part to play in fighting fraud. Trustees should manage fraud risk actively to satisfy themselves charity fraud is being managed.

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Removal of charities

In the year ended 31 March 2019 the Charity Commission removed 28 charities from the register. The regulator made inquiries into 125 charities who had not filed accounts for two or more years. During the pre-inquiry stage 69 charities submitted outstanding documents while a further 28 submitted documents and continued to operate. This resulted in over £50m being accounted for by the Charity Commission.

Off-payroll working

Engaging a contractor? Off-payroll working - changes afoot from April 2020

As if the position regarding employment status was not complicated enough, HMRC are introducing new rules to tackle what they perceive as the unfairness of those employed and paid through the payroll compared to those engaged through intermediaries such as their own personal service companies ("PSCs") which are covered by the IR35 regime. From April 2020 off-payroll working rules will be introduced in the private sector, including Not for Profit entities. The rules have been in place in the public sector, including institutions such as higher education establishments, since 6 April 2017 leading to behavioural changes and increased revenue for the Exchequer. There will also be extra responsibilities for public sector engagers from April 2020. Overall this will be a significant change for larger charities, especially those which rely on contractors for resources.

IR35 pre April 2020

Currently, under IR35 rules when a charity engages with a PSC for the supply of an individual or contractor, the responsibility and risk of assessing the employment status of the individual worker (and subsequent income tax and National Insurance implications) lies with the PSC. Therefore, as long as the charity ensures they are dealing with a bona fide company their responsibilities end there.

IR35 from April 2020

The new rules for "medium" and "large" engagers shift the responsibility to determine the employment status of a worker engaged through a PSC to the primary engager who will be required to determine the employment status of the contractor. If the relationship with the contractor is determined to be that of employment, if it were not for the PSC, the engager must arrange for/deduct income tax and National Insurance at source through the payroll on payments made to the PSC. This is similar to the way employers are already required to check the employment status of self-employed individuals to determine whether they should be included on the payroll rather than paid gross. This will be more difficult for larger charities where contractors

may be engaged by different departments with no central point in charge of this process. In the public sector, these rules have resulted in behavioural changes where large engagers without the resources to determine the employment status of all of their contractors have made the decision to place contractors on the payroll en masse, leading to positions being advertised as "non-IR35" in some cases to attract contract workers.

Charities which meet the Companies Act definitions of "medium" and "large" engagers will be required to follow the new rules. The definition of "medium" and "large" engagers is one which meets at least two out of three of the following criteria in the accounts that fall to be due before the start of the tax year in question (1) turnover in excess of £10.2m, (2) balance sheet greater than £5.1m and (3) more than 50 employees for two consecutive years. A non-corporate entity only needs to meet the turnover test to be deemed a "medium" or "large" engager. In the charity sector, HMRC has now confirmed that turnover should exclude donation and grant income. Where the entity is part of a group, the parent is considered under these size tests. If the engagement relationship is more complicated than just one PSC in the chain, the charity engager does not lose its responsibility. There are various rules regarding communicating the decision to the contractor and providing an appeal process against it.

Going forward

These new rules should come into effect from 6 April 2020. Charity engagers should ensure that they prepare for April 2020 by:

- Determining whether they are a "medium" or "large" engager required to follow the new rules;
- Implementing a process to identify contractors engaged indirectly by the charity and introducing a process to review the employment status of those currently engaged and those who will be engaged going forward;
- Communicating with contractors, particularly those who fall within the new rules; and
- Establishing the additional costs which will accrue to the engager if contracts are caught by the new rules such as employers' NICs.

PSCs will also need to consider the effects on their business if some or all of their normal income will be paid though a payroll by an engager as it will affect many areas of their business.

This is an area that the engager will need to get right as employment status is a key area in any HMRC PAYE review. PEM Employment Tax will be happy to help your business prepare whether you are an engager or an affected PSC. Please contact us on employmenttax@pem.co.uk.

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New guidance on going concern

The Financial Reporting Council (FRC) has issued new rules on how auditors should review the going concern assumption of a charity. The regime is effective from accounting periods starting 15 December 2019.

The audit report should alert readers to potential going concern risk however recent corporate failures have led to questions being asked as to how thoroughly this is being challenged by the auditor, hence the revised rules.

The new guidance emphasises that it remains the responsibility of the board to make the assumptions on going concern. It also highlights this should be part of an organisation's regular processes.

It is then the responsibility of the auditor, through tests and verification, to review management's conclusions.

As part of the audit process the auditor would expect to see evidence (in the form of scenarios and realistic projections) that the following have been considered by management in making their decision:

- The degree of uncertainty over future events
- Size, nature and complexity of the organisation
- Subsequent events that have impacted on previous judgements

The auditor is required to perform the following risk assessment procedures in reviewing management's assessment:

Auditor's assessment	Information required from the entity
▪ The entity's business model, objectives, strategies and related business risks	▪ Business strategy / future plans document
▪ The nature of the entity including how it is structured and financed	▪ Any changes to structure or financing implemented
▪ Review of the entity's financial performance including forecasts, future cashflows and management's budgeting process	▪ Post year end management accounts (at the point of the accounts being signed) ▪ Cashflow forecasts (at least 12 months from the date of signing the accounts) ▪ Budget (at least 12 months from the date of signing the accounts)
▪ Information included in the Trustees' Report on going concern (if there is concern)	▪ Wording for the Trustees' Report (if there is concern)
▪ How the entity assesses business risks relating to events / conditions which may cast significant doubt on its ability to continue as a going concern and an assessment of the significance of these risks (occurrence and potential impact)	▪ Review of risk register / risk strategy document (if available)

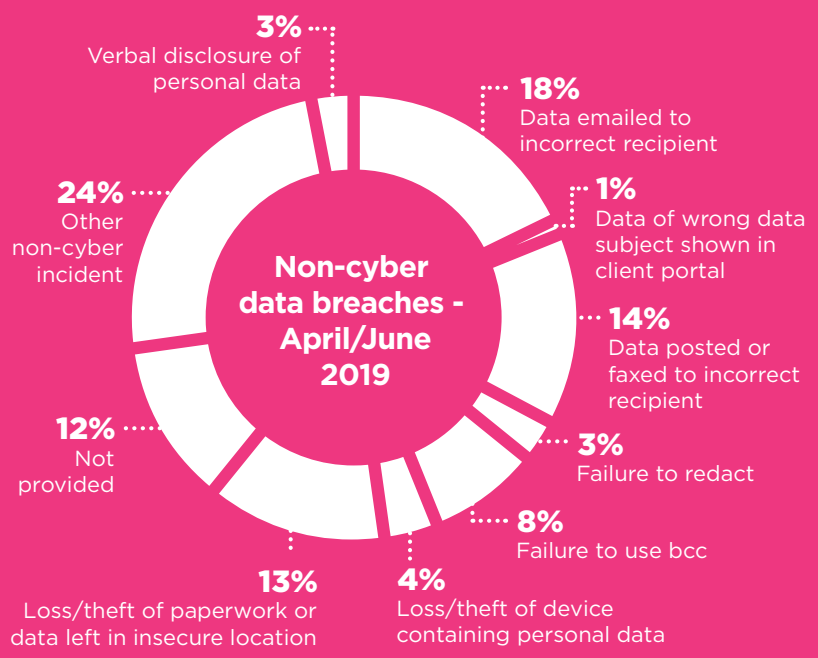
Auditors assessment	Information required from the entity
▪ The information systems in place and related business processes including: ▪ How the system captures events / conditions which may cast doubt on the entity's ability to continue as a going concern. ▪ How management identifies the relevant method, assumptions and data that are appropriate in assessing the entity's ability to continue as a going concern; and ▪ The financial reporting process used to prepare the entity's financial statements ensuring disclosures are correctly captured which relate to the entity continuing as a going concern.	▪ Discussions with management

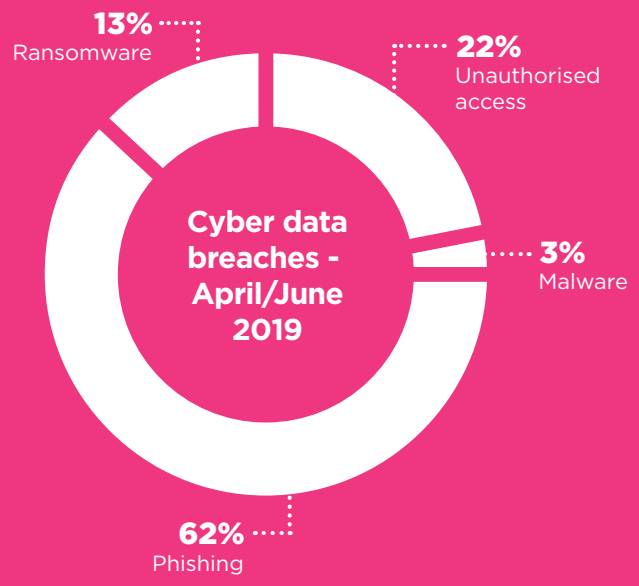
Throughout the above assessment, the auditor is expected to be alert to any other developments and enquire of management about any factors which may affect the organisation's ability to continue.

The auditor must considered all evidence, whether contradictory or corroboratory, in forming a view whilst being alert to management bias.

Data breaches to the ICO

The charts below show the data security incidents reported to the Information Commissioner's Office in the first quarter of 2019-20. Total incidents reported were 125, down slightly on the 2018-19 figure of 137. Charity non cyber incidents account for 4% of all breaches across all sectors.





Corporate Criminal Offence - Don't get caught out

The Criminal Finance Act received Royal Assent on 27 April 2017 and introduced Corporate Criminal Offence ("CCO") onto the statute books from 30 September 2017. Due to a lack of publicity, there continues to be limited awareness of these rules, however, failing to take appropriate actions can have serious consequences for your organisation.

This legislation formally criminalises the facilitation of domestic and foreign tax evasion and holds organisations accountable for the actions of its employees and agents. The title of the offence is misleading as it implies that it will only impact companies, however, the legislation has been widely drafted and therefore covers mainly incorporated charities, for example those that have been established by Royal Charter, Charitable Incorporated Organisations, charities that have been established as companies limited by guarantee or community interest companies.

Where are we now?

Following an earlier request made under the Freedom of Information Act, it has been confirmed that there are currently up to five CCO investigations underway by HM Revenue & Customs ("HMRC") which are likely to lead to cases being brought before the courts through the Crown Prosecution Service ("CPS"). Whilst HMRC is responsible for investigating cases of domestic tax evasion it is the National Crime Agency and Serious Fraud Office ("SFO") who will be responsible for investigating cases of foreign tax evasion. The SFO have declined to comment on the number of cases it is currently investigating.

The two offences

The legislation has introduced two CCO's of failure to prevent the facilitation of tax evasion ("FTP offences"):

1. Failure to prevent the facilitation of UK tax evasion offences ("UK FTP offence"); and
2. Failure to prevent the facilitation of foreign tax evasion offences ("Foreign FTP offence").

How does an FTP offence occur under CCO?

There are three stages that need to be met for an FTP offence to occur:

Stage 1: criminal tax evasion must have taken place by a taxpayer (which could be in respect of UK or foreign taxes);

Stage 2: an associated person (e.g. an employee or agent acting on behalf of the organisation), whilst

acting in that capacity has criminally facilitated the tax evasion; and

Stage 3: the organisation failed to prevent the associated person from committing the criminal facilitation act.

Extension to foreign tax evasion

The Foreign FTP offence is narrower in scope such that only relevant bodies with a UK nexus can commit this offence. Under these rules, the Foreign FTP offence can only be committed by a relevant body that is incorporated under UK law, which carries on part of its business in the UK or where the associated person is located in the UK at the time of the criminal act that facilitates the evasion of the foreign tax.

Dual criminality

There is a further requirement for dual criminality at stages 1 and 2 above:

At stage 1, the overseas jurisdiction must have an equivalent tax evasion offence and it must be the case that the actions carried out by the taxpayer would constitute a crime if they occurred in the UK.

At stage 2, the overseas jurisdiction must have an equivalent offence covering the associated person's criminal act of facilitation and it must be the case that the actions of the associated person would be criminal if they took place in the UK.

Associated persons

This has a deliberately wide definition which captures any individual that provides services for or on behalf of the organisation. It therefore could include: staff, sub-contractors, group companies, agents, JV partners or corporate trustees.

A criminal record?

If found guilty, under these new rules there would be a public record of the organisation's conviction and potential reputational damage. Additionally, the organisation may be subject to any or all of the following:

- unlimited financial penalties;
- confiscation orders or serious crime prevention orders;
- exclusion from public procurement processes; and
- disclosure to professional regulators.

How Charities can be affected?

There are various ways that charities can be caught by these rules. A few examples are noted below:

- the fundraising team issue a receipt for payment and describe it as a donation when in fact it is a payment for service allowing the individual to claim gift aid;
- backdating of documents e.g. invoices;
- the categorisation of a payment to an individual who should be deemed to be an employee but is treated as self-employed; and
- employee agrees to mis-describe services provided to a third party in order to facilitate a VAT reclaim by them.

This list is by no means exhaustive but is intended to highlight areas where the facilitation of tax evasion within your charity may occur.

Prevention really is the cure

For HMRC to bring criminal charges against an organisation under the CCO legislation; the organisation must have failed to prevent the associated person from facilitating the tax evasion. Implementing suitable prevention measures are an essential aspect of an organisation's defence against prosecution under these rules.

In their guidance HMRC have outlined the steps organisations need to take in order to remain compliant with this legislation which include:

- Undertake a Risk Assessment of the organisation to understand where the exposures to tax evasion could occur;
- Introduce controls that are Proportional to the risks identified;
- Ensure Top Level Commitment from the management which should flow throughout the organisation instilling a culture which emphasises that tax evasion is not acceptable;
- Conduct Due Diligence procedures as required on persons acting on behalf of the organisation;
- Once policies and procedures are implemented there should be Communication and Training to ensure a full understanding of the new rules; and
- Organisations should continue to Monitor and Review the risks they face and update their policies and procedures as required.

It is worth noting that the implementation of the required procedures was never intended to be cumbersome and organisations were not expected to consider every conceivable risk. The relevant body should prepare policies and procedures that are proportionate to its risk profile. If, following the risk assessment, the organisation considers it has a low risk profile and its existing policies are sufficient to catch the identified risks, the organisation can decide it does not need to introduce new procedures. In such circumstances, this decision should still be documented and evidenced as part of the organisation's defence against prosecution.

What should organisations be doing?

All organisations should make themselves aware of this new area of law and consider undertaking and documenting a comprehensive risk assessment that will form the basis of any defence against prosecution under CCO. If appropriate, this review should be complemented with the implementation of policies and procedures which demonstrate the organisation's commitment to preventing the facilitation of tax evasion. PEM have assisted a number of organisations to undertake the risk assessment and to draft clear written policy documentation to ensure compliance with this legislation.

If you have any further questions regarding any of the issues raised in this article, please do not hesitate to contact Anil Arora (aarora@pem.co.uk).

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