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Charities & Non-profit newsletter

Why might a charity need a trading subsidiary?

There are a variety of reasons why a charity may wish to set up a wholly owned subsidiary. It is important for trustees to be able to understand and justify why a separate company is needed, particularly as often the charity will need to fund the subsidiary's activities, whether by upfront funds or providing services and cash on an ongoing basis.

There is also an administrative burden involved and extra costs for accounting and tax requirements for the subsidiary.

Minimising risk

A charity may have identified an opportunity to expand its activities. If these activities present a greater level of risk than the charity currently faces, then the trustees may wish to ring-fence these activities within a separate company to protect the charity's assets.

Encouraging commerciality and transparency

If separate teams are involved in different activities, the separation of the financial results by using two entities may provide a stronger focus for each of the teams. In addition, separate companies could offer greater transparency to external stakeholders. This could be achieved through accounting disclosures and divisional management accounts, but some charities prefer to use separate companies.

Entering into a joint venture

If the charity is entering into a joint venture with a commercial partner, the use of a separate vehicle may be required. For example, if the commercial partner is seeking a return on their investment via dividends, or if both the charity and the commercial partner are contributing assets or cash to a particular project, such as property development (although a separate vehicle may also be required for tax reasons in this situation).

Also, if external bank financing is being sought, it may be preferable for the subsidiary to be the borrower, not the charity. Commercial joint ventures can be complex, and advice should be sought before the charity decides to proceed with a particular structure.

It is worth noting that where a company is not wholly owned by one or more charities, the option of paying cash under a deed a covenant within 9 months of the year end to secure tax relief in the previous accounting period is lost. Instead, relief is only received if the donation is made within the accounting period.

Reducing income tax or corporation tax exposure

It is well known that, other than the small trading exemption, charities have no income tax or corporation tax exemption where they undertake non-primary purpose trading activities.

As a reminder, the small trading exemption allows the profits of a trade to be exempt where the turnover is below a certain threshold, as described below:

Charity's gross annual income	Maximum permitted small trading turnover
Under £32,000	£8,000
£32,001 - £320,000	25% of the charity's total annual turnover
Over £320,000	£80,000

This may be sufficient to cover minor activities such as selling souvenirs in a small gift shop, or selling Christmas cards, saving the charity the administration or cost of setting up a separate subsidiary.

If the turnover exceeds the thresholds above then to save the corporation tax which would otherwise be incurred by the charity, the activity can be undertaken in a subsidiary which then gifts its taxable profits to the parent charity, sheltering the profits from tax.

If a charity is intending to invest in a partnership or Limited Liability Partnership, it is important to remember that these are transparent for tax purposes, so the charity should consider whether its share of the profits of the partnership/LLP could create a tax liability within the charity. If it does then investment via a subsidiary company may be preferable.

Saving VAT

For some building projects the charity may find that it is suffering a significant VAT cost on professional fees. Where this is the case, it may be possible to make savings by using a "design and build" arrangement with a subsidiary company.

The charity enters into a zero-rated building contract with the subsidiary, which in turn subcontractors to a construction company. The subsidiary incurs all of the professional fees and recharges these back to the charity. As the subsidiary is fully taxable it can recover the VAT on the professional fees, but no VAT is suffered by the charity because of the zero-rating. It is important to consider the mark-up which should be applied by the subsidiary and also consider whether it is necessary to register the subsidiary under the construction industry scheme.

Other matters

If the decision is made to set up a new subsidiary, then it is important to consider the tax implications, funding methods and identify any recharges which will be necessary to ensure neither the charity nor the subsidiary fall into any tax traps.

Judith Pederzolli
Director, Business Tax

e. jpederzolli@pem.co.uk

Political activity and campaigning by charities

New 5 minute guide: political activity

In Orlando Fraser KC's speech to the Charity Commission Annual Public Meeting 2022, the new 5-minute guide on charities and political activity was unveiled.

The 5-minute guide is, in the style of the other guides, intended to be shorter, more accessible, and provide examples to aid understanding. CC9 Campaigning and political activity guidance for charities provides more detailed guidance and was updated on 7 November for the new Elections Act 2022.

In his speech, he stated that the charities sector has a long, proud history of pushing for meaningful change that improves the lives of their beneficiaries, and makes society fairer and kinder. He gave the example of the charity, Tommy's, which received an award at the Civil Society Charity Awards for its outstanding campaign to improve the care received by families experiencing miscarriage. The campaign laid bare many injustices, including that black women are much more likely to suffer miscarriages than white women and had an impact in changing the way miscarriages are counted and support are offered.

"So, the law is clear that charities are free to campaign and engage in political activity in this way, shining a light on uncomfortable truths, engaging with those in power in the interests of the people and causes they serve. And when done well, campaigns of this nature can have immense impact. So, the law does not agree with those who say that charities should simply not dabble in politics at all."

- Orlando Fraser KC

However, charities must never stray into party politics. The guidance includes a helpful checklist for those charities thinking about campaigning which includes guidance on assessing the risks of the campaign and whether the objectives could be achieved by other methods.

Katy Gradon
Trainee, Audit & Accounts

e. kgradon@pem.co.uk

Are you a UK charity or non-profit? We would like to hear from you!

Kreston Global is gathering data from UK charities to understand the issues they face.

We would like to invite you to participate in a short-survey where the responses will form the basis for the Kreston UK Charities Report due to be published in 2023. If you would like to take part, please click here.

Cost of living crisis

In December, the Charity Commission has published guidance about cost of living related financial difficulties in charities. See the guidance here.

Charities in cost of living crisis

Orlando Fraser KC expressed, in his speech at the Charity Commission AGM, that even amid the cost of living crisis, he has every optimism that charities will again meet the needs of the age, buoyed by the huge generosity of the British public, and the dedication and commitment of volunteers and those working in charities. Although we could give more by some international standards, the British public still gave almost £11bn to charity last year, and around 5.5 million people regularly volunteer.

However, the Charity Commission recognises that many charities are facing rapidly increasing costs and many charity beneficiaries and staff are similarly under pressure. At the same time donors may also be facing financial constraints, creating a 'perfect storm' for charities.

The new guidance sets out a few key reminders for trustees when navigating these choppy waters. These are not changed from the main duties set out in the essential trustee and other Charity Commission guidance, but under pressure it may be more difficult for trustees to provide the effective financial stewardship expected.

- **Act within your powers** - during the pandemic many charities tried instinctively to help but for some it was outside their original purpose; as charities adapt to changing circumstance trustees must ensure that their actions are still appropriate for the charities objects.
- **Act in your charity's best interests** – trustees may face difficult decisions balancing the needs of beneficiaries now with the needs of future beneficiaries as there is a risk that spending now may mean reduced services or even closure later.
- **Assess risk** – as the charity operates in a difficult economic environment there may be changes in controls and processes, both financial and in safeguarding beneficiaries and staff. Trustees need to have oversight and understanding of the risks and consequences of their decisions.
- **Evaluate the financial position** – basic cash flow forecasting and scenario planning are expected.

The guidance includes advice on management fuel costs and reliefs available for charities, including discounts applied (energy bill relief scheme) and ensuring the correct rate of VAT is paid (VAT for charities).

Detailed guidance is provided about what to do if the difficulties increase, including mergers, closure and when to report a serious incident to the Charity Commission.

Charities Act 2022: information about the changes being introduced

The Charities Act 2022 amends the Charities Act 2011. The Charities Act 2022: implementation timetable was summarised in the August 2022 Newsletter. We have set out below a short summary of those elements coming into force in Autumn 2022. Further guidance and information can be found on the Charity Commission website.

The most significant change is the delay in bringing the new ex gratia payment rules into force. The DCMS implementation plan currently states that these provisions are under further consideration prior to commencement.

Although no reason for the delay is given in the implementation plan, Civil Society Minister Lord Kamall discussed the matter in the House of Lords on 13 October when discussing the National Heritage Act. He noted that the provisions 'have the effect of enabling national museums for the first time to restitute items from their collections, based on moral grounds', and that 'no such intent was considered, nor agreed on', therefore the Government are deferring commencement 'until we fully understand the implications for national museums and other charities'.

However, other measures are now in force (from 31 October 2022).

Paying trustees for providing goods to the charity

Charities already have a statutory power that they can use, in certain circumstances, to pay trustees for providing a service to the charity beyond usual trustee duties; however currently a trustee can only be paid for goods that are supplied as part of a service. This is now extended to apply to goods supplied separately.

However, charities should remember that there are potential risks and conflicts that may arise when making payments to trustees or other related parties. The Charity Commission guidance is set out in Payments to charity trustees: what the rules are.

As a reminder, Charity Commission consent remains necessary when your governing document does not allow you to pay trustees, in particular when and before the charity:

- employs a trustee, or a connected person
- pays a trustee for serving as a trustee
- pays a trustee's expenses or replace lost income
- pays a trustee or connected person for providing goods or services to the charity.

Trustees should have procedures in place to manage conflicts of interest and report on trustee payments in the trustees' annual report and accounts.

Fundraising appeals that raise too little or too much

There have always been questions asked when appeals either do not raise the amount needed to deliver the project or when excess funds are raised, about what can be done with the money.

To support charities through the changes, new guidance was published in October 2022, to coincide with the new provisions coming into force.

Separate guidance has been published for the two scenarios although NHS charities must follow their separate guidance.

- Charity fundraising appeals: using donations when you've raised more than you need; and
- Charity fundraising appeals: using donations when you have not raised enough money or you cannot achieve your appeal purpose.

This guidance sets out clear step by step summaries of the actions trustees should take. However, the key point for trustees and management to be aware of, is getting the wording right first time as this could save considerable time and effort down the line.

To this end, the Charity Commission also published new guidance in October on charity fundraising appeals: appeal wording and record keeping.

Key elements of the guidance include considering a secondary purpose or make the appeal broad. The examples given are to use phrasing such as:

Secondary purpose: "We are raising funds to buy a modern scanner for our animal rescue centre. If we have donations left after the purchase, or we are unable to buy the scanner, we will spend your donations on other equipment for the centre."

Broad appeal: "Here is an example of one of our projects. To support this and other projects that we run, please give a donation to our charity."

Power to amend Royal Charters

There was also new guidance published for Royal Charter charities in conjunction with the Privy Council Office (PCO), which sets out how and when charities should approach either the Commission or the PCO to ensure applications to be processed efficiently. It covers applying for a Royal Charter, making amendments, merging and getting regulatory advice.

Other provisions

Other more administrative provisions are set out in the Charity Commission guidance for charities on the website and include changes to the Charity Tribunal and to the Commission's scheme-making powers.

Nikki Loan
Partner, Audit & Accounts

e. nloan@pem.co.uk

International Non-Profit Accounting Guidance (INPAG)

There are no international standards guiding non-profit organisations (NPOs) (non-governmental organisations (NGOs) and other non-profit organisations) on how to prepare their annual audited accounts. While a few countries have their own standards for NPOs, these differ from each other. International standards that exist for businesses do not address all the needs of NPOs' stakeholders, for example accounting for grants.

The International Financial Reporting for Non Profit Organizations (IFR4NPO) initiative is a five-year project coordinated by Humentum and CIPFA to develop the first ever NPO international financial reporting guidance. The International Non-Profit Accounting Guidance (INPAG) aims to provide greater clarity and consistency for the financial reports prepared by non-profit organisations, such as charities, NGOs and faith groups. The International Non-Profit Accounting Guidance (INPAG) concepts and principles have been adapted from the IFRS for SMEs Accounting Standard and take into account some of the conceptual frameworks used in the development of IFRS Accounting. Stakeholders, including auditors, regulators, donors, public interest groups and non-profit organisations themselves, are being asked to comment on the guidance. The consultation period is open until 31 March 2023.

The process has already taken the best part of a decade, with the first survey on the subject dating back to 2014, when 72% of respondents from 179 countries backed the need for an international non-profit accounting standard. The Exposure Draft of INPAG released at the World Congress of Accountants in November is the first of three that will collectively comprise the guidance.

It sets out the overall framework for financial reporting for NPOs. The remaining two Exposure Drafts will be released in 2023. Final guidance is due to be published in 2025.

Charities and terrorism

The compliance toolkit was updated in November 2022, to signpost to new guidance from the Crown Prosecution Service on proscription offences and terrorist financing offences and cases involving humanitarian, development and peacebuilding work overseas.

The guidance sets out that while the Commission does not expect all trustees to have a detailed knowledge of the guidance, all trustees should have a broad understanding.

The guidance states:

It is an essential duty for trustees to manage their charity's resources responsibly, including any risk to its assets, people, or reputation from being used or abused to support or otherwise be involved in terrorism.

Trustees should review regularly their procedures and use the toolkit to identify any gaps in their knowledge or procedures. The key areas covered are:

- Chapter 1: Charities and Terrorism
- Chapter 2: Charities: due diligence, monitoring and verifying the end use of charitable funds
- Chapter 3: Protect your charity from fraud and cyber crime
- Chapter 4: Charities: holding, moving and receiving funds safely
- Chapter 5: Protecting charities from abuse for extremist purposes

Nikki Loan
Partner, Audit & Accounts

e. nloan@pem.co.uk

Charities at risk of 'underestimating' online fraud

The Charity Commission has warned charities against the risk of online fraud. A new survey found around one in eight charities (12%) had experienced cybercrime in the previous 12 months.

This follows earlier findings indicating that the pandemic prompted increasing numbers of charities to move to digital fundraising and operating, exposing them to the risk of cybercrime.

Most concerningly to the Charity Commission, the survey highlighted a potential lack of awareness of the risks facing charities online, with just over 24% having a formal policy in place to manage the risk.

Similarly, only around half (55%) of charities reported that cyber security was a fairly or very high priority in their organisation.

The Charity Commission's new survey explored charities' experiences of online cyber-attacks. It found that over half of charities (51%) held electronic records on their customers, while 37% enabled people to donate online. A greater digital footprint increases a charity's vulnerability.

The most common types of attacks experienced were phishing and impersonation (where others impersonate the organisation in emails or online). For both attacks personal data is often at risk, and both attacks can often be countered by awareness training and testing.

Charity Commission guidance is available to help trustees **here**. Protect your charity from fraud and cybercrime, which includes links to the **National Cyber Security Centre (NCSC) toolkit**.

Fundraising Regulator Annual Complaints Report 2021/2022

The Fundraising Regulator has recently published its Annual Complaints Report data for 1 April 2021 to 31 March 2022. The report indicates that digital tools are being used more often and by more charities, and identified that although complaint volumes had risen in some areas there were proportionately fewer complaints in relation to fundraising activity compared to 2019/20.

Complaints received by the Fundraising Regulator

Complaints about misleading information increased by 17% (from 60 in 2020/21 to 70 in 2021/22) and over half of these related to either digital (email, social media, online fundraising platforms or other digital channels) or advertising fundraising.

With increased activity, it is not surprising that digital fundraising methods are some of the most complained about.

Charities need to consider the content and structure of their fundraising materials to make sure that information on different channels is open, honest and not likely to mislead.

Complaints about digital by theme

[Fundraising Regulator complaints report 2021/22]

Vulnerability is explicitly mentioned in a small number of cases (15 in 2021/22 and 12 in 2020/21) but is threaded through many complaints where other issues are of primary concern. The breadth of activities that result in complaints, and the potential impact for both the donor and charity, mean it is important for fundraisers to appropriately identify and respond well to such circumstances.

Concerns about fundraiser behaviour, dislike of method, and pressure to donate often feature in complaints about fundraising methods that are commonly carried out by third parties on behalf of a charity.

Where the Fundraising Regulator does investigate, they state that they find that charities often fail to adequately monitor third parties or to handle complaints effectively.

Complaints reported by a sample of the UK's largest fundraising charities

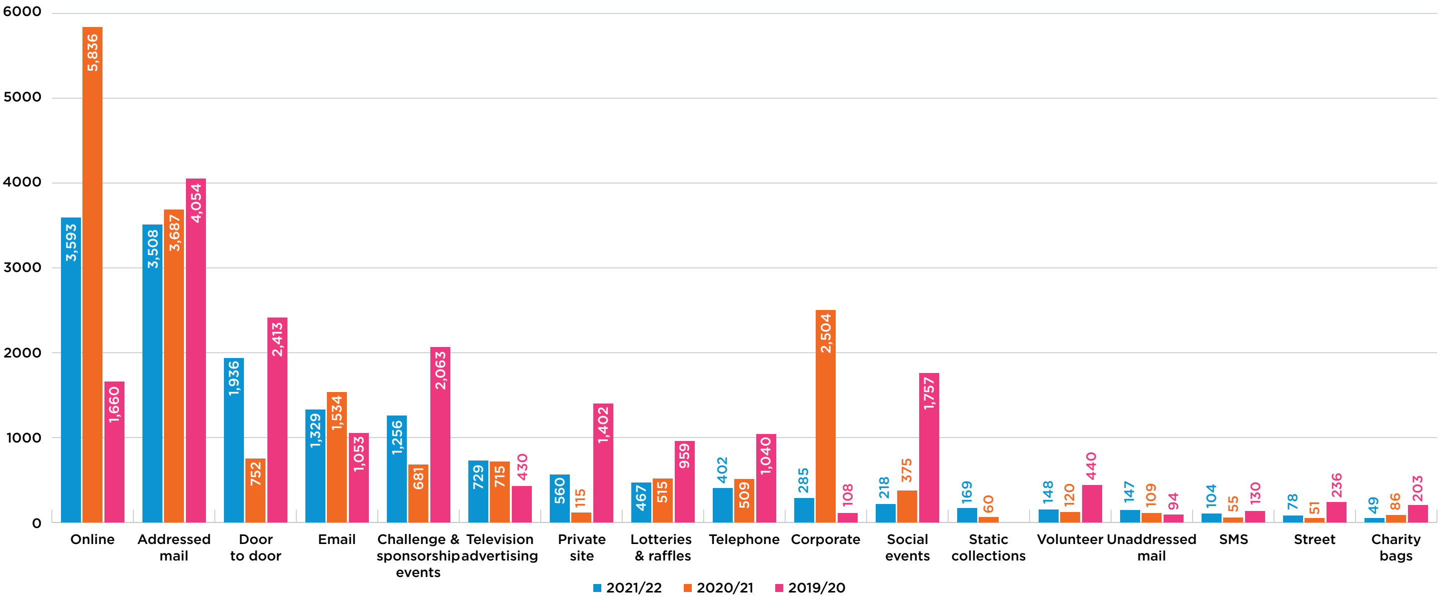
It appears that in 2021/22 many charities resumed using in-person fundraising methods such as collections and events that were paused or restricted earlier in the pandemic. Broadly, complaint numbers have risen in line with this increased activity.

However, charities have generally not yet returned to pre-pandemic activity levels.

Most methods had proportionally fewer complaints in relation to activity in 2021/22 than compared to 2019/20.

Overall, the total complaints reported by the sample charities has continued to decrease since 2019/20 to 15,104 complaints in 2021/22. This could be for a variety of reasons including changes in activity as result of the pandemic, fewer activities being carried out which are more likely to result in complaints, or because charities are improving the way they mitigate risks and comply with the fundraising standards.

Comparing 2020/21 to 2021/22, the charity complaints data presents a mixed picture. Complaint numbers for some methods such as addressed mail (5% decrease from 3,687 to 3,508) and television advertising (2% increase from 715 to 729) have remained broadly similar. Other methods have seen a significant change such as online fundraising (38% decrease from 5,836 to 3,593) and door to door (157% increase from 752 to 1,936).



[Fundraising Regulator complaints report 2021/22]

Kelly Bretherick
kbretherick@pem.co.uk

Nikki Loan
nloan@pem.co.uk

Michael Hewett
mhewett@pem.co.uk

Kathryn Hebden
khebden@pem.co.uk

Gemma Baratte
gbaratte@pem.co.uk

Judith Pederzolli
jpederzolli@pem.co.uk

Kate Millard
cmillard@pem.co.uk

Robert Plumbly
rplumbly@pem.co.uk

PEM
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

pem.co.uk

KRESTON GLOBAL