

HAYSMACINTYRE ANNUAL INDEPENDENT SCHOOLS' CONFERENCE

ARE THE PROCEEDINGS BROUGHT BY THE INDEPENDENT SCHOOLS COUNCIL AGAINST THE CHARITY COMMISSION LIKELY TO LEAD TO A NEW APPROACH TO PUBLIC BENEFIT?

BACKGROUND

The Charities Act 2006 ('the Act') introduced a potentially seismic change to how organisations are construed to be charities. Prior to the Act, if a charity's purposes upheld the relief of poverty, the advancement of religion or the advance of education it was presumed those purposes were for the public benefit. The Act placed a new burden on charities to demonstrate that their purposes benefit the public or a section of the public. It is a long established principle of charity law that a trust is not charitable unless it is directed to the public benefit: however, charities must now prove it. Although the definition of 'public benefit' continues to be derived by common law, the Charity Commission ("the Commission") has produced guidance on the public benefit requirement based on its reading of case law. Very broadly, the Guidance prescribes the two public benefit principles as follows:-

- (1) there must be an identifiable benefit or benefits

Important factors:

 - 1a It must be clear what the benefits are
 - 1b The benefits must be related to the aims
 - 1c Benefits must be balanced against any detriment or harm
- (2) the benefit must be to the public, or sufficient section of the public.

Important factors:

 - 2a The beneficiaries must be appropriate to the aims
 - 2b Where benefit is to a section of the public, the opportunity to benefit must not be unreasonably restricted:
 - by geographical or other restrictions; or
 - by ability to pay any fees charged
 - 2c People in poverty must not be excluded from the opportunity to benefit
 - 2d Any private benefits must be incidental

In order to qualify as a charity, the trustees must demonstrate the charity's adherence to these principles in its annual report. Much debate has revolved around whether the Guidance offers sufficient certainty: how do trustees know when they have satisfied the test?

THE INDEPENDENT SCHOOLS COUNCIL V THE CHARITY COMMISSION

In October 2010 the High Court granted the Independent Schools Council ('the ISC') the right to bring judicial review proceedings against the Commission. The case will be heard in conjunction with the Attorney-General's referral of the matter to the Charity Tribunal, as is his right under the Act. Most likely the ISC's judicial review and the Attorney-General's Reference will be heard in tandem in the Upper Tribunal.

The Attorney-General's Reference will ask the court to apply the Commission's Guidance to an extensive range of factual scenarios to see if the Guidance stands up to practical scrutiny. The ISC's judicial review proceedings will focus on the Guidance itself and whether, as currently drafted, the Commission's interpretation of public benefit accords with the common law position. Independent Schools will be hoping the process leads to the publication of clearer guidance.

WHAT ARE THE LEGAL ARGUMENTS?

Given that the potential material issues are numerous, this piece can only offer a snapshot insight as to the kind of points which may arise:-

A challenge that the Commission have underestimated the public benefit conferred by independent schools

A frequently cited argument of independent schools is that they benefit the public at large by producing well educated persons. That said, the Charity Tribunal may not find value in this argument (see *Oppenheim v Tobacco Securities Trust Co Ltd* where the benefit conferred to society of well educated persons did not avert the basic truth that an insufficient section of the public stood to benefit from the organisation's activities).

Another frequent claim by independent schools which the ISC may draw to the court's attention is the significant public saving made on account of the hundreds of thousands of pupils not requiring a state education. This

saving is thought to be over £2.5 billion based on British pupils in ISC schools in England and Wales but the cost could be even greater if one considers not only the education of children but the acquisition of additional property that would be needed to accommodate them. The Commission are stipulating very strongly the need for increased bursaries and free places in some schools.

In legal terms the problem is that the courts may not accept such a broad and indirect demonstration of public benefit as a saving to the exchequer. A reading of case law would suggest that the courts have historically held that public benefit is only proved through a positive demonstration of direct and tangible activities. Although the Charity Commission and case law have emphasised the need for a demonstration of *direct* benefits to the wider community, perhaps equal weight may be given to *indirect* benefits.

The charitable contributions made by schools are multi-dimensional and cannot be measured purely in terms of education because, schools also carry out charitable acts for the other two heads of charity, namely the relief of poverty and the advancement of religion. These benefits should be considered through the broad lens of the three heads of charity in the context of the wider community rather than through the narrow lens of how the school is conferring a benefit on local children.

If the Commission place emphasis on the numbers game (i.e the award of bursaries and free places) this would ignore other voluntary work carried out by fee-paying schools both in the UK and overseas. For example, would the Charity Commission Guidance allow for adequate credence to be given to the commitment of private schools to charitable schemes, for example schemes to help the sick in Lourdes or successful fundraisers? How are such indirect benefits to be assessed?

However, what the court should consider is that these arguments are not 'legal' per se. The court should be minded to consider in addition to case law arguments of public policy: namely that over-zealous Guidelines and a strict requirement for bursaries and free places deplete the budgets of independent schools, which will indirectly place a greater strain on the state's education budget.

A challenge to the lack of certainty

The Act was borne of ideology. The overriding objective seems to have been to create a new culture whereby independent schools benefit the poorer strands in society and where public and private sectors worked in tandem to end the so-called 'education apartheid' and break the 'glass ceiling' (Alan Milburn, Hansard, 2006). The

intention was never to create a mere numbers game. Problematically the Commission's reports on five independent schools created the impression of a numbers game, but did not state what the numbers were!

In July 2009 the Commission published a series of reports on various charities including assessments of five fee-paying schools. One assessed school (Highfield Priory School in Preston) was judged in the 2009 assessment to have fallen short of satisfying the public benefit test but, when re-assessed in 2010, the trustees were deemed to have addressed the issues, viz. the introduction of bursaries and increased provision of facilities for the local community, and to have satisfied the public benefit test. The question is whether the Commission can illuminate the precise point where the Charities were deemed to have satisfied the test.

Chief Executive of the ISC David Lyscom stated: 'The entire sector is at the whim of the Commission's prevailing and subjective view as to what is 'sufficient' for a school to get the all-clear.' But, quite palpably, it was always the Commission's intention for each case to be judged on its merits. This approach is perhaps valid on the basis that a school can satisfy the public benefit through a wide range of direct (bursaries) and indirect (sharing a swimming pool with a local maintained school) activities. Additionally, determining how the 'public, or a section of the public' is defined will differ between charities and will depend on whom the charity's aims intend to benefit. In this respect the Commission are merely following the legal principle set out in the public benefit case of *Re Foveaux* [1895] to consider 'each case as it arises, upon its own special circumstances'. The *nub* of the Commission's approach can be summarised as follows:

- 'the question whether a purpose will or may operate for the public benefit is to be answered by the court forming an opinion on the evidence before it: ie.
- is there a public benefit;
- is the benefit to the public or a section of the public.' (Charity Commission, December 2008).

Such a construction is sound and imposes a standardised test derived directly from case law rather than an inventive construction. The court may however interpret the emphasis on the two principles as imposing a procedural approach which is arguably ultra vires (in excess of its powers). For example, take the recent history of anti-tax avoidance law: it was felt that the anti-avoidance cases of the 1980s (*Furniss v Dawson*) had imposed a procedural framework which detracted from the court's duty, as in any case, to make a judgment based on the facts before it.

In terms of how the Commission have interpreted the law, a case-by-case approach is arguably the correct approach in law. However, in light of who the Charity Commission are dealing with – thousands of independent schools – a case-by-case approach is potentially a bureaucratic minefield.

The Charity Commission also say they do not regard satisfying public benefit as a numbers game:

'Who constitutes 'the public, or a section of the public' is not a simple matter of numbers, but the number of people who can potentially benefit (now or in the future) must not be negligible.' (*This statement is derived from Oppenheim v Tobacco Securities Trust Co Ltd*).

What is material in this regard: (1) the number of people who actually benefit or (2) the number of people who can *potentially* benefit? The guidance indicates the latter, but in its assessments of independent schools the Commission has encouraged a real increase in bursaries. This is but one facet of the confusion.

Clearly independent schools feel that the Commission's case-by-case approach is unsatisfactory and arbitrary and that if schools are required to adhere to new requirements this should be accompanied by an objective and definite framework. Many Independent schools are critical of what Sir Edward Coke once described as 'the crooked hand of discretion'. Independent schools feel entitled to be given precise figures of, for example, the minimum percentage of students who should benefit from bursaries for the school to satisfy the public benefit test. The effect of vagueness, lest we forget, is to undermine the Rule of Law (as Joseph Raz stated in 1979, 'the law must be capable of guiding the behaviour of its subjects'). The risk of imposing numerical standards however is that independent schools may meet the minimum standard, but do precious little more. This was not the underlying intention of the government when the Act was introduced.

There is also the potentially problematic conundrum that schools may increase bursaries and free places, but that these places will not automatically go to students from disadvantaged backgrounds as the architects of the Act hoped and assumed.

A challenge that the Commission have acted beyond its powers

The court will need to consider whether the Commission have acted ultra vires. In the Commission's defence, it produced guidance as required by the Act and was careful not to make any deduction without case law

support. On the other hand – and this is where it becomes contentious – it is not clear whether there is a link between case law and the Commission's stipulation that schools must provide more bursaries and free places. Is such a stipulation ultra vires?

The Commission are quick to provide a disclaimer that the Guidance does not constitute the law on public benefit and that they seek to interpret, rather than make, the law. In this sense they are not acting ultra vires. Nevertheless the Commission's Guidance (and failure to comply with it) holds weighty implications for charities regardless of whether or not it has 'statutory' force.


CONCLUDING THOUGHTS

The development of the public benefit requirement is potentially a party-political issue. Alan Milburn MP spoke of the 'education apartheid' whilst, in the same Parliamentary debate Andrew Turner, Conservative MP for the Isle of Wight, protested that charities would be 'guilty until proven innocent'. Hopefully with judicial input any impending change will be driven by the law and the surrounding practical issues, rather than ideology.

If an organisation is to benefit in the order of around £100 million through tax relief at the expense of the exchequer (i.e. the *public* purse) then accordingly it is not unreasonable to require the organisation to demonstrate a *public* benefit. The corresponding argument to the argument of tax benefits is, of course, that those who send their children to private schools pay twice; first for the high private fees and second for the state sector through taxes.

In the case of *Re Shaw's Will Trusts* the court held that the public benefit may be so manifestly clear that to call evidence on the question would be an absurdity. The current position is that evidence must be called to account in respect of all charities, irrespective of the extent to which public benefit is satisfied and, it was felt by the previous government, too many independent schools took their charitable status for granted. Quite whether the coalition government will intercept with their own ideological agenda will be the subject of much scrutiny.

It is hoped that the proceedings for judicial review will clear the fog surrounding the public benefit test. In addition, the Attorney-General's decision to make a reference to the Charity Tribunal should also lay down practical guidance. The credibility of the Commission's Guidance will therefore depend on whether it can withstand theoretical and practical judicial scrutiny. That said, a great deal of the Commission's Guidance is derived from case law – including the two broad principles – and provided the court do not dispute the Commission's interpretation of the



case law they will not dispute the Guidance. Perhaps the court will however dispute the manner in which the Commission has applied the Guidance.

One potential solution is supplementary guidance for the three main heads of charity (education, religion and relief of poverty). The Charity Commission refers in its literature to *Gilmour v Coats* [1949] wherein 'a section of the public' was considered and said to be interpreted differently across the three categories of charity. Perhaps the Commission's Guidance should reflect this distinction.

The implications of the public benefit requirement will continue to have wide reaching consequences in the sphere of education. For example, what of universities who are forced to raise fees on the back of the 2010 top-up fees? Will universities be gambling on their charitable

status if they fail to take in a sufficient number of students from poorer backgrounds? The upcoming court cases may have ramifications beyond the world of private schooling.

One is left with the impression that the forthcoming court hearing will be instructive and useful for all concerned. Given the contentious nature of the issues at hand guidance and policy can only be moved forward through sensible agreement after wide consultation and dialogue, with due reference to the law but not in neglect of practical considerations. In addition, indirect benefits may be given equal weight as direct benefits. The challenge is however whether this approach reflects the principal purpose of the 2006 Act which is, lest we forget, that charities must now positively demonstrate public benefit.

CHARITABLE INCORPORATED ORGANISATIONS: WHAT ARE THEY AND WILL THEY TAKE OFF ?

BACKGROUND

When a charity is incorporated it will typically be a company limited by guarantee, which means the trustees must comply with regulations imposed by both company law and the Charity Commission. Charities are doubly burdened and it has long been considered a practical step forward to create a new legal structure specifically for charities. In response Charitable Incorporated Organisations (CIOs) were introduced under the Charities Act 2006 and are anticipated to come into form in 2011 (though it is not clear whether the legislation will be phased in piecemeal and no commencement date has yet been made). CIOs are already overdue given Parliament did not find time in the 2009-2010 session to introduce the Act.

Why is a CIO different from a company limited by guarantee?

The Charity Commission states the following aspects as unique to CIOs:

- A CIO only comes into existence once it is registered with the Commission;
- There is no minimum income registration threshold for CIOs;
- All CIOs will have to submit accounts and annual returns to the Commission regardless of income; and
- CIOs will have to comply with the other additional responsibilities outlined in the Charities Act 2006 and the CIO Regulations.

But perhaps the most significant distinction is that the organisation will be constituted, registered and regulated solely by the Charity Commission, will not report to Companies House and will be released from duties under the Companies Act 2006. This means filing only one annual report and one set of accounts.

In what way is it the same?

As with companies limited by guarantee, CIOs retain the benefits of body corporate status, including:

- the limited liability of trustees
 - Note that the CIO's constitution must state whether or not its members are liable to contribute to the company's assets if the company is wound up, together with details of the extent of such contribution;

- the convenience of having a legal entity under which business can operate (for example deeds and documents will be executed in the company's name rather than in the names of individual trustees).

Who can incorporate as a CIO?

The CIO structure is open to all new charities and unincorporated associations. The Charities Act 2006 also provides a conversion process for organisations currently incorporated as a company limited by guarantee.

How do we register?

The registration process will depend on what kind of organisation you are but, generally, you will register with the Charity Commission rather than Companies House and should supply the following with any application:-

- (1) the organisation's proposed constitution;
- (2) any documents required by regulations made by the Minister; and
- (3) any other documents the Commission may request.

What happens after incorporation as a CIO?

Similar to a standard incorporation process, the CIO will become incorporated in accordance with the information supplied to the Charity Commission. Therefore the CIO's members will be those named in the application documentation although, whereas the trust property was previously vested in the trustees, it will now be vested in the CIO.

What do the trustees need to do after incorporation as a CIO?

The trustees must continue to observe their duties, for example acting in good faith and not benefiting personally from arrangements. In terms of practicalities, the Charity Commission gives the following advice:-

'As the CIO will be a new legal entity it will have a new registered charity number and you will need to inform banks, funders and suppliers of the transfer. You will need to ensure that any existing contracts are assigned to the CIO.'

Will they take off?

Charities should not take any steps until Parliament take the initiative to set a commencement date for the Act (based on the assumption they actually do so!). There is nonetheless a growing interest in CIOs amongst incorporated and non-incorporated charities. The chief selling point of CIOs is the removal of the shackles of dual-registration and the circumvention of Companies House whilst simultaneously enjoying the benefits of incorporation, such as limited liability. The ears of charitable trustees will be pricking. Trustees should not however underestimate the administrative load. If you are a trustee of an unincorporated organisation considering CIO status do bear in mind that whilst the administrative

burden will be less than with a company limited by guarantee, a CIO is still an incorporated organisation with reporting requirements and duties in excess of those under a simple trust structure. Unincorporated charities will therefore need to consider their liabilities and weigh them against this administrative burden. Medium and upwards sized charities will certainly need to consider the benefits.

The outline provided in this article is merely an overview and conditional but before considering any application for CIO status it is vital that trustees or directors convene a meeting to discuss the charities needs and purposes before taking good legal advice.

Disclaimer

This Article does not seek to replicate the arguments or views of any one body and in particular it represents the views of the authors at LBMW rather than those of the ISC. For the legal arguments being advanced by the ISC please see the Charity Tribunal website (www.charity.tribunals.gov.uk) and in particular their Grounds of Claim

Lee Bolton Monier-Williams
1 The Sanctuary, London SW1P 3JT

Tel: +44 (0)20 7222 5381 Fax : +44 (0)20 7799 2781
academies@lbmw.com
www.lbmw.com

The articles in this booklet are intended as a general guide to the legislation. They do not represent advice, and are not intended to replace the need to consult solicitors on a specific issue or transaction. No liability is accepted for any inaccuracies or omissions.