



The Law Reform Commission
AN COIMISIÚN UM ATHCHÓIRIÚ AN DLÍ

REPORT

CHARITABLE TRUSTS
AND
LEGAL STRUCTURES FOR CHARITIES

(LRC 80-2006)

IRELAND

The Law Reform Commission
35-39 Shelbourne Road, Ballsbridge, Dublin 4

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The Law Reform Commission 2006
First Published October 2006

ISSN 1393 – 3132

THE LAW REFORM COMMISSION

Background

The Law Reform Commission is an independent statutory body whose main aim is to keep the law under review and to make practical proposals for its reform. It was established on 20 October 1975, pursuant to section 3 of the *Law Reform Commission Act 1975*.

The Commission's Second Programme for Law Reform, prepared in consultation with the Attorney General, was approved by the Government and copies were laid before both Houses of the Oireachtas in December 2000. The Commission also works on matters which are referred to it on occasion by the Attorney General under the terms of the Act.

To date the Commission has published 78 Reports containing proposals for reform of the law; 11 Working Papers; 39 Consultation Papers; a number of specialised Papers for limited circulation; An Examination of the Law of Bail; and 26 Annual Reports in accordance with section 6 of the 1975 Act. A full list of its publications is contained on the Commission's website at www.lawreform.ie

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Charities Bill	Bill 213 54/1	Eng
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Companies (Northern Ireland) Order 1986	S.I. 1986/1032 (N.I. 6)	NI
Companies Act 1990	No. 27/1990	Irl
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Income and Corporation Tax Act 1988	1988 c. 1	UK
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Royal Agricultural Society of England v Wilson	(1924) TC 62	Eng

INTRODUCTION

1. The voluntary sector in Ireland is rich and diverse and has played a significant role in the economic and social development of communities and society as a whole. Charities comprise one part of the voluntary sector and the value of the charity sector has been estimated to be worth €2 billion.¹ The Commission's *Second Programme of Law Reform 2000-2007* includes the law of trusts and charities.² This Report follows 2 Consultation Papers – on Charitable Trust Law and on Legal Structures for Charities – published in 2005 by the Commission.³

2. There is currently no definition of a 'charity' as such. Charities are identified and defined by reference to their 'charitable purposes'. In *Commissioners for Special Purposes of Income Tax v Pemsel*,⁴ 4 categories of charitable purposes (the 'Pemsel' categories) were identified: the relief of poverty; the advancement of education; the advancement of religion and other purposes "beneficial to the community". The draft *Charities Bill 2006* proposes to introduce a clear statutory definition of "charitable purposes" and "charity".

3. The 2 Consultation Papers also came against a wider background of proposals for the general reform of the regulation of charities. In 2003 the Department of Community, Rural and Gaeltacht Affairs published a Consultation Paper *Establishing a Modern Statutory Framework for Charities*. The Department's proposals envisaged the establishment of a charities regulator and a formal register of charities. Subsequently the Commission agreed to assist the Department on aspects of the proposed new framework, in particular the role and function of charities trustees. The

¹ See *Submission from the Charities Regulation Study Group to the Department of Community, Rural and Gaeltacht Affairs on the Consultation Paper on Establishing a Modern Statutory Framework for Charities*, May 2004. For a number of reasons, including the lack of an agreed definition of charity and the lack of a charities registration system, this figure can only be taken as a guide.

² *Second Programme for Examination of Certain Branches of the Law with a view to their Reform 2000-2007* (PN 9459) (December 2000).

³ *Consultation Paper on Charitable Trust Law: General Proposals* (LRC CP 36-2005) and *Consultation Paper on Legal Structures for Charities* (LRC CP 38-2005).

⁴ [1891] AC 531.

Consultation Paper on Charitable Trustees was published against that background.

4. Since the publication of the 2 Consultation Papers, the *General Scheme for the Charities Regulation Bill 2006* was published in March 2006 by the Department of Community, Rural and Gaeltacht Affairs.⁵ The draft *Charities Bill 2006* includes the first statutory definition of charity, proposes to establish a register of charities and to put in place a regulatory framework for registered charities under the auspices of a Charities Regulator. The draft *Charities Bill 2006* incorporates many of the provisional recommendations in the Commission's *Consultation Paper on Charitable Trust Law*.⁶ It does not include any provision covering a particular legal structure for charities, which was the subject matter of the Commission's *Consultation Paper on Legal Structures for Charities*.⁷

5. In Chapter 1 the Commission considers the role of the proposed new Charities Regulator as set out in the draft *Charities Bill 2006*. It also reviews the provisions in the draft *Charities Bill 2006* concerning charity trustees and the extent to which the provisional recommendations in the Commission's *Consultation Paper on Charitable Trust Law*⁸ have been incorporated into it.

6. In Chapter 2 the Commission examines the need for a new legal structure for charities in Ireland. The Commission considers recent developments in other jurisdictions on this and highlights the benefits of having a charity specific legal structure available in this State.

7. Chapter 3 considers the difficulties encountered by charities who engage in trading activities. The Commission discusses whether existing provisions are sufficient in light of the increasing numbers of charities who engage in trading activities.

8. Chapter 4 is a summary of the Commission's recommendations.

9. The Appendix contains a draft Bill arising from the recommendations in the Report.

⁵ Available at www.pobail.ie/en/CharitiesRegulation/

⁶ (LRC CP 36-2005).

⁷ (LRC CP 38-2005).

⁸ (LRC CP 36-2005).

CHAPTER 1 CHARITY TRUSTEES

A Introduction

1.01 In its *Consultation Paper on Charitable Trust Law: General Proposals*,¹ the Commission made a number of provisional recommendations on the powers, functions and duties of charity trustees. Since the publication of the Consultation Paper, the *General Scheme for the Charities Regulation Bill 2006*² (“the draft *Charities Bill 2006*”) was published by the Department of Community, Rural and Gaeltacht Affairs in March 2006. The draft *Charities Bill 2006* incorporates many of the provisional recommendations in the Consultation Paper. In submissions received on the Consultation Papers there was general approval of the approach taken by the Commission and thus the Commission confirms that approach in this Report.

1.02 This chapter concentrates on the provisions in the draft *Charities Bill 2006* concerning charity trustees, and re-iterates some of the recommendations in the Commission’s Consultation Paper. To put those provisions in context the Commission outlines the functions of the proposed Charities Regulator.

B New Charities Regulator

1.03 The draft *Charities Bill 2006* proposed to establish an independent Charities Regulator. It is envisaged that the Charities Regulator will have the following objectives:

- To increase public trust and confidence in charities;
- To promote compliance by charity trustees with their legal obligations in exercising control and management of the administration of their charities;
- To promote the effective use of charitable resources;

¹ (LRC CP 36-2005).

² Available at www.pobail.ie/en/CharitiesRegulation/

- To enhance the accountability of charities to donors, beneficiaries and the general public;
- To promote awareness and understanding of the operation of the public benefit requirement.³

1.04 The Charities Regulator will have the following general functions:

- To determine whether institutions are or are not charities;
- To establish and maintain an accurate and up-to-date register of charities;
- To encourage, facilitate and monitor compliance by charities with the legislation, including by taking prosecutions for offences under the legislation in appropriate circumstances;
- To identify and investigate apparent misconduct or mismanagement in the administration of charities and to take remedial or protective action in connection with such misconduct or mismanagement;
- To encourage and facilitate the better administration and conduct of charities by the provision of information or advice, including issuing of guidance notes, best practice guidelines, codes of conduct, and model constitutional documents;
- To carry on such activities or to publish such information concerning charities as it considers appropriate in the public interest;
- To give information (including statistical information) or advice, or to make proposals, to the Minister for Community, Rural and Gaeltacht Affairs on matters relating to the functions of the Regulator.⁴

1.05 A graduated approach to compliance with the legislation is envisaged in the case of certain specific matters.⁵ Where a registered charity or charity trustees agree to rectify the non-compliance, the Charities Regulator will have the discretion to adopt a persuasive approach in the first instance by the application of one or more intermediate sanctions:

- removing the charity from the register;

³ Head 13 of the draft *Charities Bill 2006*.

⁴ Head 14 of the draft *Charities Bill 2006*.

⁵ Failure to comply with a requirement to change the name of the charity or failure to comply with the requirements in relation to annual accounts, audit and annual returns.

- publishing the name of the charity on the website of the Charities Regulator;
- entering into a written agreement to take the necessary remedial action within specified time limits.⁶

If the agreed rectification is not carried out within the period specified, the Charities Regulator will then proceed to prosecution in the normal way.

1.06 The Charities Regulator will be given powers, either of its own motion or by order of the High Court, to take civil action in order to ensure compliance with the legislation. These will include the power to institute inquiries; to call for documents and search records; to enter premises; to suspend, remove or appoint charity trustees; to freeze charity assets; and to co-operate on an administrative basis with foreign statutory bodies on law enforcement matters.

1.07 Decisions made by the Charities Regulator in the performance of its functions will be subject to judicial review or to appeal on a point of law (with full appeals to the High Court also provided for on certain matters).

1.08 There will also be an option of keeping disputes resolution out of the courts system. The draft *Charities Bill 2006* proposes to establish a Charity Appeals Board.⁷ An appeal, or an application for review, may be brought to the Charity Appeals Board against a decision made by the Charities Regulator. A decision of the Charity Appeals Board could then be appealed to the High Court on a point of law.⁸

1.09 The Commission welcomes the introduction of a new independent regulatory body for charities and sees this as an important development which will enhance the operation of the charity sector, promote public confidence in charitable activities and provide a framework to protect the public interest.

C Charity Trustees

(1) Introduction

1.10 In its *Consultation Paper on Charitable Trust Law: General Proposals*,⁹ the Commission made provisional recommendations on the roles, duties, powers and responsibilities of charity trustees. As mentioned already many of these have been incorporated into the draft *Charities Bill*

⁶ Head 71 of the draft *Charities Bill 2006*.

⁷ Heads 126 to 129 of the draft *Charities Bill 2006*.

⁸ Head 128 of the draft *Charities Bill 2006*.

⁹ (LRC CP 36-2005).

2006 and were supported in the submissions received by the Commission on the Consultation Paper. The Commission, in this Report, will therefore confine itself to a review of the recommendations and, where relevant, the corresponding provisions of the draft *Charities Bill 2006*.

(2) Charity Trustees

1.11 In the Consultation Paper, the Commission recommended a definition of charity trustees¹⁰ which has been largely incorporated into the draft *Charities Bill 2006*, namely, as “the persons, whether or not officers, having the general control and management of the administration of a charity and includes the directors and other officers of a charity that is established as a company”.¹¹

(3) Capacity and Suitability to act as a Charity Trustee

1.12 In the Consultation Paper, the Commission noted that one of the fundamental requirements of granting charitable status to an entity is that its purposes must possess sufficient public benefit, that is, it must benefit the community or an appreciable section of the community. There is, therefore, a public interest aspect to charities which is not a requisite for private trusts created for the benefit of identified beneficiaries or classes of beneficiaries. The Commission confirms its view that given this public aspect, and that the funds of a charity are funds in which the public have an interest, a more stringent attitude should be adopted in considering who may act as trustee of a charity, and that the State, in the interests of the public, should regulate who may act as trustees of charities.

1.13 In the Consultation Paper, the Commission provisionally recommended that a minor should be prohibited from acting as a charity trustee¹² and also that qualifying criteria for the appointment of charity trustees should be embodied in legislation.¹³ The Commission notes that both of these recommendations have been incorporated into the draft *Charities Bill 2006*, which makes provision for the disqualification of a charity trustee where he or she

- is a minor;
- is a ward of court or where an enduring power of attorney has come into effect;
- is adjudicated bankrupt;

¹⁰ See the Consultation Paper at paragraph 3.09.

¹¹ Head 2 of the draft *Charities Bill 2006*.

¹² See the Consultation Paper at paragraph 1.10.

¹³ See the Consultation Paper at paragraph 1.12.

- makes a composition or arrangement with creditors;
- is a corporate trustee which is in liquidation or has been wound-up;
- is convicted of an indictable offence;
- is sentenced to a term of imprisonment by a court of competent jurisdiction;
- is disqualified or restricted from being a director of any company (within the meaning of the *Companies Acts 1963 to 2005*) or is disqualified under the provisions of the *Pensions Acts 1990 to 2002*;
- has been removed from the office of charity trustee by an order of the High Court under section 70 of the draft *Charities Bill 2006*.¹⁴

1.14 In the Consultation Paper, the Commission invited views as to whether the Charities Regulator should have power to waive a disqualification.¹⁵ The draft *Charities Bill 2006* proposes that the Charities Regulator may waive a person's disqualification either generally or in relation to a particular charity or a particular class of charities.¹⁶ The draft Bill also makes it an offence for a person to act as a charity trustee while disqualified.¹⁷

1.15 In the Consultation Paper, the Commission also considered whether the Charities Regulator should maintain a list of charity trustees who have been disqualified. The draft *Charities Bill 2006* provides that the Charities Regulator shall maintain a list of all persons who have been removed from office and that the entries in the list shall be available for public inspection in legible form at all reasonable times.¹⁸

(4) Appointment of Charity Trustees

1.16 In the Consultation Paper, the Commission provisionally recommended that the Charities Regulator should have power to appoint replacement or additional charity trustees.¹⁹ This is reflected in section 7 of Schedule 2 to the draft *Charities Bill 2006* which empowers the Charities Regulator to appoint new charity trustees.²⁰ The Charities Regulator may

¹⁴ Head 105(1) of the draft *Charities Bill 2006*.

¹⁵ See the Consultation Paper at paragraph 1.63.

¹⁶ Head 105(2) of the draft *Charities Bill 2006*.

¹⁷ Head 106 of the draft *Charities Bill 2006*.

¹⁸ Head 105(4) and (5) of the draft *Charities Bill 2006*.

¹⁹ See the Consultation Paper at paragraph 1.34.

also appoint additional trustees as part of its power to act for the protection of charities.²¹

(5) Removal of Charity Trustees

1.17 In the Consultation Paper, the Commission recommended that the Charities Regulator should have power to remove charity trustees but that this power should be accompanied by an appropriate appeals process to the courts.²² The draft *Charities Bill 2006* provides that as part of its power to act for the protection of charities, the Charities Regulator may by order of the High Court remove any trustee, charity trustee, officer, agent or employee of the charity who has been responsible for or privy to the misconduct or mismanagement or has by his or her conduct contributed to it or facilitated it.²³ The draft *Charities Bill 2006* also provides that the Charities Regulator may also remove a charity trustee by order of the High Court:

- (a) where, within the last 5 years, the charity trustee:
 - (i) having previously been adjudged bankrupt or had his or her resources sequestered, has been discharged, or
 - (ii) having previously made a composition or arrangement with, or granted a trust deed for, his or her creditors, has been discharged in respect of it;
- (b) where the charity trustee is a corporation in liquidation;
- (c) where the charity trustee is incapable of acting by reason of lack of mental capacity;
- (d) where the charity trustee has not acted, and will not declare his or her willingness or unwillingness to act;
- (e) where the charity trustee is outside the State or cannot be found or does not act, and his or her absence or failure to act impedes the proper administration of the charity.²⁴

²⁰ Similar to the powers previously exercisable by the Commissioners of Charitable Donations and Bequests pursuant to section 43 of the *Charities Act 1961*, as amended by section 14 of the *Charities Act 1973*.

²¹ Head 70(1)(iii) and 70(4) of the draft *Charities Bill 2006*.

²² See the Consultation Paper at paragraphs 1.54 and 1.55.

²³ Head 70(1)(ii) of the draft *Charities Bill 2006*.

²⁴ Head 70(3) of the draft *Charities Bill 2006*.

(6) Suspension of Charity Trustees

1.18 In the Consultation Paper, the Commission also recommended that the Charities Regulator should have power to suspend persons from acting as charity trustees, for a period of 6 months, following the institution of an investigation or inquiry.²⁵ The draft *Charities Bill 2006* allows the Charities Regulator to suspend a charity trustee but only in circumstances where within 14 days it has applied to the High Court for an order for his or her removal.²⁶ The Regulator may also apply to the Court for an order suspending a trustee of a scheme pending completion of an investigation into the state and conduct of the scheme.²⁷

(7) Remuneration of Charity Trustees

1.19 In the Consultation Paper, the Commission concluded that it was not appropriate to introduce a statutory default provision on remuneration of charity trustees. The Commission considered that the voluntary nature of charitable activities should be maintained to ensure public confidence in the administration of charities.²⁸ Charities must have an element of public benefit and giving charity trustees a right to charge for their services may undermine the voluntary ethos of charitable activities. It may also undermine public confidence in the charity sector by giving the impression that funds donated to a charity may be used for administrative rather than charitable purposes.

1.20 But the Commission did provisionally recommend that trustees could be remunerated for *non-trustee services*. The Commission considered that safeguards should be introduced which would emphasise remuneration would not be allowed for services provided by a person acting in the capacity of trustee.²⁹

1.21 The draft *Charities Bill 2006* provides that, having regard to guidance from the Charities Regulator and to the requirement to act in accordance with the duty of care, a charity would be empowered to pay remuneration to a person who is either a trustee of the charity or is connected with a trustee of the charity and might receive a benefit as a result of the person's remuneration.³⁰ The draft Bill provides that remuneration would be in respect of *non-trustee services* only.

²⁵ See the Consultation Paper at paragraph 1.67.

²⁶ Head 70(1)(i) of the draft *Charities Bill 2006*.

²⁷ Head 70(10) of the draft *Charities Bill 2006*.

²⁸ See the Consultation Paper at paragraph 2.08.

²⁹ See the Consultation Paper at paragraph 2.14.

³⁰ Head 110 of the draft *Charities Bill 2006*.

1.22 The draft *Charities Bill 2006* also contains safeguards to prevent misuse of this power. Before entering an agreement to pay remuneration, the charity trustees must have regard to any guidance given by the Charities Regulator concerning the making of such agreements. In addition the duty of care will apply to a charity trustee when making a decision to pay such remuneration.³¹

(8) Duty of Care

1.23 In the Consultation Paper, the Commission considered the duty of care and standard of care required of charity trustees. The Commission was mindful of the need to ensure that the standard of care required was not set so high as to discourage individuals from becoming involved in voluntary activities, but at the same time would ensure that public confidence in the charity sector is maintained by providing that funds donated to a charity are properly applied for the purposes of the charity.³²

1.24 The draft *Charities Bill 2006* provides for a general statutory duty of care along the lines recommended by the Commission. The proposed statutory duty of care which would apply to all charity trustees is framed as follows:

A charity trustee must, in exercising functions in that capacity, act in the interests of the charity and must, in particular:

- (a) seek, in good faith, to ensure that the charity acts in a manner which is consistent with its purposes and
- (b) act with the care and diligence that it is reasonable to expect of a person who is managing the affairs of another person
- (c) in circumstances capable of giving rise to a conflict of interest between the charity and any person responsible for the appointment of the charity trustee –
 - (i) put the interests of the charity before those of any other person, or
 - (ii) where any other duty prevents the charity trustee from doing so, disclose the conflicting interest to the charity and refrain from participating in any deliberation or decision of the other charity trustees with respect to the matter in question.³³

³¹ Head 111 of the draft *Charities Bill 2006*.

³² See Chapter 3 of the Consultation Paper.

³³ Head 108 of the draft *Charities Bill 2006*.

(9) *Liability of Charity Trustees*

1.25 A trustee may be found to be acting in breach of trust if he or she fails to perform the duties required or acts in an unauthorised manner. A breach of trust may occur in a variety of circumstances, such as investment of trust monies in unauthorised investments, or failure to exercise the appropriate degree of supervision over the management of the trust by co-trustees.

1.26 In the Consultation Paper, the Commission addressed the question of the liability of charity trustees for breach of trust.³⁴ The Commission concluded that there should be no distinction between the liability of lay and professional trustees and that the court should be given discretion to excuse trustees of liability where they have acted honestly, reasonably and in good faith.³⁵

1.27 This view was in line with the Department of Community, Rural and Gaeltacht Affairs' 2003 Consultation Paper – *Establishing a Modern Statutory Framework for Charities* which had also recommended that a statutory exoneration be provided for lay trustees against liabilities arising out of acts committed honestly, reasonably and in good faith.³⁶

1.28 These views have been incorporated in the draft *Charities Bill 2006* which provides that the Charities Regulator may apply to the High Court for an order to grant relief to a charity trustee from personal liability for a breach of trust or breach of duty. This will apply where the Charities Regulator considers that the charity trustee, whether a lay or professional trustee, has acted honestly and reasonably and ought fairly to be excused for the breach of trust or duty.³⁷

(10) *Trustee Indemnity Insurance*

1.29 Trustee indemnity insurance indemnifies a trustee against the risk of personal liability, whether to the charity or to a third party, arising from his or her breach of trust. Where the charity is incorporated or where it carries out part of its business through a separate company, the trustee's personal liability for wrongful acts as a company's directors or officers may also be covered. It provides cover against liabilities which are those of the trustee, rather than those of the charity.

³⁴ See Chapter 7 of the Consultation Paper.

³⁵ See the Consultation Paper at paragraph 7.18.

³⁶ *Establishing a Modern Statutory Framework for Charities* at 16.

³⁷ Head 109 of the draft *Charities Bill 2006*.

1.30 The draft *Charities Bill 2006* provides that charity trustees may arrange for the purchase of indemnity insurance out of charity funds, where they are satisfied that it would be in the best interests of the charity to do so, and provided that they act in accordance with the duty of care.³⁸ The provisions relating to the purchase of indemnity insurance contain safeguards to prevent abuse of the power.

(11) Investment Powers

1.31 In the Consultation Paper, the Commission considered that a default statutory power of investment which would allow trustees to invest trust funds as if they were absolute beneficial owners was inappropriate. The Commission provisionally recommended that the statutory power of investment should continue to be governed by the statutory scheme of authorised investments.

1.32 The draft *Charities Bill 2006* proposes to confer a general power of investment on charity trustees.³⁹ While this is currently drafted in general terms, the Commission assumes that, in final form, this is likely to provide as at present, that unless the constitution of the charity provides otherwise, charity trustees would be obliged to invest in investments specified by Orders made under section 2 of the *Trustee (Authorised Investments) Act 1958*.

(12) Default Administrative Powers

1.33 The draft *Charities Bill 2006* proposes to confer default administrative powers to assist in the administration of those charities with unwritten or incomplete/deficient constitutions (in the main, older charities).⁴⁰ Such default administrative powers will be introduced by way of Regulations if found to be necessary.

1.34 The following is a list of the suggested default administrative powers:

- power to dissolve a charity;
- power to pay expenses and ex gratia payments;
- power to borrow in specified circumstances (for example, to maintain buildings or to develop land for charitable purposes);
- power to merge with another registered charity with similar charitable purposes;

³⁸ Head 112 of the draft *Charities Bill 2006*.

³⁹ Head 115 of the draft *Charities Bill 2006*.

⁴⁰ Head 121 of the draft *Charities Bill 2006*.

- power to acquire and manage freehold and leasehold land;
- power to insure property;
- power to employ agents;
- power to appoint nominees;
- power to appoint a custodian.⁴¹

1.35 Any default administrative powers conferred on charity trustees by Regulations would apply only where no contrary provision or exclusion is contained in the constitution of the charity. In addition, the exercise of any such powers would be subject to the prior consent of the Charities Regulator.

(13) Number of Trustees

1.36 In the Consultation Paper, the Commission noted that currently there is no minimum number of charity trustees required to operate a charity. For the purposes of granting charitable tax exemption, the Revenue Commissioners specify that there should be a minimum of 3 trustees, officers or directors (who are not related) and that the majority must be resident within the State.⁴²

1.37 The Commission considered that, given the public aspect of trustee activities and that they are effectively managing funds in which the public have an interest, stringent controls should be put in place. The Commission also considered that increased numbers of trustees would enhance internal accountability and safeguard the assets and funds of the charity against possible fraud. The Commission therefore provisionally recommended that a minimum of 3 trustees be required to act for a charitable trust, or 3 officers in the case of an unincorporated association. The Commission also provisionally recommended that while a corporate trustee may act as sole trustee, in such a case there should be at least 3 directors on the board of directors.⁴³ If the numbers fall below 3, and the person or persons having power to appoint new charity trustees are unable or unwilling to do so, the Charities Regulator should have power to appoint additional trustees to bring the numbers back up to the statutory minimum.

1.38 The draft *Charities Bill 2006* is silent on the number of trustees required to act for a charity. Given the Revenue requirement of 3 charity

⁴¹ See Schedule 3 of the draft *Charities Bill 2006*.

⁴² See Revenue Leaflet *Applying for Relief from Tax on the Income and Property of Charities* - CHY 1 November 2005.

⁴³ See the Consultation Paper at paragraphs 1.17 to 1.25.

trustees it would seem advisable to include a similar requirement within the proposed charity legislation. Otherwise anomalies may arise where charities with less than 3 charity trustees may be in a position to register as a charity with the Charities Regulator and yet be unable to avail of charitable tax exemption.

1.39 In the course of the consultation which followed the publication of the Commission's *Consultation Paper on Charitable Trust Law*, it was suggested that the number of charity trustees required might be linked to the income and/or the value of the assets of the charity. In other words, the number of charity trustees required should be increased where the income or the assets of the charity exceeds specified amounts. Having considered this proposal, the Commission has concluded that it may be difficult to implement in practice and that the imposition of a requirement for more than 3 charity trustees may render decision making within a charity more difficult and the administration of the charity more complex. The increased accountability of charity trustees under the draft *Charities Bill 2006* should lessen, to some degree, the requirement of large numbers of charity trustees to monitor the activities of charities. For the reasons already given the Commission therefore confirms the provisional recommendation in the Consultation Paper that there should be a minimum number of 3 charity trustees or officers.

1.40 The Commission recommends that a minimum of 3 trustees be required to act for a charitable trust or 3 officers in the case of an unincorporated association. The Commission recommends that where a corporate trustee acts as sole trustee, in such circumstances there should be at least 3 directors on the board of directors. If the numbers fall below 3 and the person or persons having power to appoint new charity trustees are unable or unwilling to do so, the Charities Regulator should have power to appoint additional trustees to bring the numbers back up to the statutory minimum.

1.41 As already noted, in the Consultation Paper, the Commission provisionally recommended that, in the case of a charity operating through a company there should be at least 3 directors on the board of directors. However, the Commission noted that any legislation in this regard would have to form part of the current review and consolidation of company law and provisionally recommended that the Company Law Review Group might consider this recommendation as part of its work. Since publication of the Consultation Paper, the Commission has consulted with representatives of the Company Law Review Group. The aim of the Company Law Review Group is to streamline and simplify company legislation and it is therefore not intended to set different criteria for different types of companies. It is thus clear to the Commission that any requirement regarding a minimum number of trustees of charitable incorporated entities should be dealt with in

the Charities Bill which will follow on from the draft *Charities Bill 2006* rather than in the context of company law reform. The Commission has therefore concluded that proposals in this area should be specific to the charities sector only, to which the Commission now turns.

CHAPTER 2 LEGAL STRUCTURES FOR CHARITIES

A Introduction

2.01 Charities may be constituted in many different ways and all charitable activity requires some form of legal structure within which to operate and, if relevant, within which to hold charitable property. Charitable status is dependent on an organisation having charitable purposes, rather than on the specific legal form that is taken.¹ The distinction between charitable status which relates to the existence of charitable purposes and a charity's legal structure should be noted. The choice of structure lies with those who create the charity, or with those who control it. In this Chapter, the Commission examines the need for a new legal structure for charities in Ireland. The Commission is particularly conscious in this Report of the recent developments in other jurisdictions in this respect.

B The Commission's Consultation Papers

2.02 In its *Consultation Paper on Charitable Trust Law General Proposals*,² the Commission noted that “[c]harities currently operate under various different legal structures and each of these structures has a separate body of law governing its operation”. This creates obvious difficulties in any attempt to codify any set of rules to apply across all the different legal structures. The Commission therefore returned to the topic of legal structures in its *Consultation Paper on Legal Structures for Charities*.³

2.03 The Consultation Paper examined the traditional legal structures used by charities including the charitable trust, the unincorporated association and the company – usually a company limited by guarantee.⁴

¹ Certain charities are recognised by the Revenue Commissioners as qualifying for charitable exemption from tax liability. However, it should be noted that not all charities apply for tax exemptions and this does not affect their status as a “charity”. The fact that a body may not have an exemption from tax may not necessarily mean that that body is not a charity.

² (LRC CP 36-2005) at 3.

³ (LRC CP 38-2005).

⁴ There are also other charitable bodies such as societies incorporated by charter (for example, the Royal College of Surgeons in Ireland), or created by statute or under other legislation (such as the industrial and provident societies legislation).

Charitable trusts are subject to general trust law, unincorporated associations are subject to general contract law and charitable companies are subject to company law. Each structure is also subject to the law of charities. As noted above, this creates difficulties in any attempt to regulate and codify any set of rules to apply across all of the different legal structures.⁵ Difficulties relating to the interaction of charity and trust and company law have also been encountered in other jurisdictions.⁶

2.04 The Commission's view was that, since none of the current legal structures were specifically designed with charities in mind, this causes problems. The legal form which a charity takes should be designed to assist, not complicate, the work of the charity. Each of the current legal structures available to charities comes with its own advantages and disadvantages. The main distinction lies between the incorporated charities (companies) and the unincorporated charities (trusts and associations). Charitable companies sit somewhat uncomfortably between charity law, based on trust law, and company law which was designed primarily for commercial organisations. On the other hand, incorporation offers the comfort of limited liability which is not available in the case of trusts and unincorporated associations.⁷ In addition, a company is a separate legal entity from its members and continues in existence despite changes in its membership.

2.05 Having considered the issues involved, the Commission provisionally recommended the introduction of a new form of legal structure for charities, to be called the Charitable Incorporated Organisation (CIO).⁸

2.06 The Commission was also mindful that, regardless of which legal structure is chosen, it is imperative that trustees or officers or directors need to be aware of their legal responsibilities. In many instances, charities hold funds which have been donated by the general public, who have no further

⁵ In its Consultation Paper, *Establishing a Modern Statutory Framework for Charities* December 2003, p 16 the Department of Community, Rural and Gaeltacht Affairs proposed that the law should be codified so that the role, duty of care, responsibilities and duties of charity trustees/officers/directors would be confirmed as being the same no matter what form of legal structure or governing instrument was used.

⁶ In England, the *Trustee Act 2000* does not apply to charitable companies. The Law Commission of England and Wales (whose recommendations formed the basis for the Act of 2000) had concluded that "it had become apparent in finalising the recommendations that there would be considerable technical difficulties in doing so... [c]haritable corporations are not necessarily subject to all the rules applicable to trustees, and it is by no means clear that it would be appropriate for some of the proposed provisions (such as those relating to powers of delegation) to be applied to them" see Law Commission Report *Trustees' Powers and Duties* (No. 260 1999) at paragraph 1.20.

⁷ See the Consultation Paper at paragraphs 1.43 and 1.44.

⁸ See the Consultation Paper at paragraph 4.41.

scope for monitoring the use of the funds they have given. Many charities also receive substantial tax benefits. For these reasons, it is important that all charities are held accountable and that regulation is applied uniformly regardless of the legal structure used.

C Draft Charities Regulation Bill 2006

2.07 The *General Scheme for the Charities Regulation Bill 2006* does not make any provision for a new legal form for charities. The press release which accompanied the publication of the draft Bill contained the following comment on the issue:

“Charities have the choice of a number of different legal forms, e.g., unincorporated, such as a trust or an unincorporated association, or incorporated, such as a company (usually limited by guarantee, rather than shares).

The question of whether there could be a new legal form, especially for charities, has been raised by bodies such as the Law Society and the Law Reform Commission. Substantive consideration by the charities sector as to how any new legal form should be different from the current company limited by guarantee has yet to take place. No charities-specific comments were received in response to the public consultation on the proposals of the Company Law Review Group for reform of company law.

It is not intended to hold up progress in introducing legislation to regulate the charities sector for the first time in Ireland, as promised by the Government, pending consideration of separate, longer-term questions such as this.

However, in conjunction with relevant Government Departments and other bodies, the Department of Community, Rural and Gaeltacht Affairs will continue to monitor developments, including the outcome of the review foreseen in the UK within five years of the proposed introduction of a new form of incorporation for charities, the Charitable Incorporated Organisation (CIO).”⁹

2.08 This passage appears to suggest that the Department was mindful to postpone consideration of this issue but it also suggests that the primary objective was to ensure that it would not hold up the general reform process. The Commission notes that its provisional recommendations in this area have also been acknowledged and that the Department ‘will continue to

⁹ <http://www.pobail.ie/en/CharitiesRegulation/PressReleases/file,6891,en.pdf>

monitor developments'. The Commission agrees that this issue should not hold up the general reform of charity regulation and considers that for a variety of reasons it merits inclusion in the current reform proposals.

2.09 First, with the advent of a new independent regulatory body for the charities sector, the issue of legal responsibilities of those with executive responsibility will be emphasised. In this regard, the Commission welcomes the proposal that one of the functions of the Charities Regulator will be "to encourage and facilitate the better administration and conduct of charities by the provision of information or advice, including in particular by way of issuing (or, as it considers appropriate, approving) guidance notes, best practice guidelines, codes of conduct, and model constitutional documents".¹⁰

2.10 Second, the Commission notes that the Department's Consultation Paper¹¹ did not directly address the issue of legal structures for charities. The Department's Consultation Paper considered that the development of a new legal structure for charities was an issue to be considered as part of the Company Law Review Group's process.¹² However, it is now clear that the new Companies Bill will not incorporate any provision for a new charitable designated activity company as envisaged in the Department's Consultation Paper.¹³ The Commission remains of the view, supported by a number of submissions it has received,¹⁴ - and which the Department would not have been aware when the draft *Charities Bill 2006* was published - that the advent of a new regulatory body provides an ideal opportunity to integrate the functions currently carried out by the existing bodies which govern charitable activities and to streamline procedural requirements for charities. The development of a new legal structure for charities should be seen as an integral part of the reform process. A separate new legal structure would provide an opportunity to streamline the registration and regulation of charities so that all charities regardless of their legal status would be subject to the same form of regulation.

2.11 Thirdly, in Ireland, 44% of the 6,700 charities granted tax-exempt status by the Revenue Commissioners are currently constituted as companies limited by guarantee. By contrast of the 170,000 charities registered with the Charity Commission for England and Wales only 15% are constituted as companies. The principal reason why charities opt for incorporation is to

¹⁰ Head 14(1)(e) of the draft *Charities Bill 2006*.

¹¹ *Establishing a Modern Statutory Framework for Charities*.

¹² *Ibid* at 17.

¹³ See further at paragraphs 2.74 to 2.82 below.

¹⁴ See further at paragraphs 2.67 and 2.68 below.

avail of the protection afforded by limited liability and also because certain grants are only available to incorporated organisations. The Commission considers that many charities are forced to incorporate as companies simply because there is currently no other option available to them if they wish to avail of the benefits of limited liability for their members or to avail of certain grants. The Commission therefore recommends that the general reform of charity regulation should include the issue of the legal structure of charities.

2.12 *The Commission recommends that the general reform of charity regulation should include the issue of the legal structure of charities.*

D Other Jurisdictions

(1) Introduction

2.13 In the wake of devolution in the United Kingdom, there are 3 distinct charity law regimes in the UK, each with their own legislation and administrative systems. England and Wales has a Charity Commission¹⁵ and a fully operational compulsory register of charities, while Scotland has recently established a charity regulator and a register.¹⁶ A charity commission and register for Northern Ireland has recently been proposed.¹⁷ Tax relief for charities is an excepted matter, dealt with by HM Revenue & Customs on a UK-wide basis.

2.14 In the Consultation Paper, the Commission noted that the existing forms of legal structures used by charities in Ireland are almost identical to those currently used in other common law jurisdictions, most notably in England and Wales and Scotland. Both of those jurisdictions have decided to introduce a new legal structure for charities. More recently, in Northern Ireland, the Department for Social Development has also proposed a new CIO structure for charities.¹⁸ The Commission also considered developments which are taking place at a European level in relation to legal frameworks for voluntary organisations.¹⁹ The Commission now turns to provide an overview of developments in these jurisdictions.

(2) England and Wales

2.15 Unlike the position in Ireland, charities in England and Wales have been subject to regulation by the Charity Commissioners for many

¹⁵ <http://www.charity-commission.gov.uk/>

¹⁶ <http://www.oscr.co.uk/>

¹⁷ http://www.dsdni.gov.uk/dsd_charities_review.pdf

¹⁸ http://www.dsdni.gov.uk/dsd_charities_review.pdf

¹⁹ See Chapter 3 of the Consultation Paper.

years. The Charity Commissioners were initially established in 1853 and their functions and powers are now contained in the *Charities Act 1993*. The Charity Commission carries out supervisory, policing and advisory functions. It maintains a register of charities which is open to public inspection. All charities, including charitable companies, are subject to regulation by the Charity Commission.

2.16 The recommendation for a new legal form specifically for charities arose from the Department of Trade and Industry's Company Law Review.²⁰ The proposal for a Charitable Incorporated Organisation (CIO) was subsequently developed by an advisory group set up by the Charity Commission.

2.17 A comprehensive review of the legal and regulatory framework governing charities and other not-for-profit organisations was subsequently published in September 2002. The report *Private Action, Public Benefit*, prepared by the Prime Minister's Strategy Unit, made a series of recommendations intended to modernise charity law, including recommendations aimed at improving the range of available legal forms enabling organisations to be more effective. The report recommended that a "new legal form designed specifically for charities, the Charitable Incorporated Organisation (CIO), be introduced, which will only be available to charitable organisations."²¹

2.18 Following an extensive consultation process, in July 2003, the Government published its response to the Strategy Unit's proposals – *Charities and Not-for-Profits: A Modern Legal Framework*.²² In its response, the UK Government accepted the recommendation that a new legal form be introduced for charities and indicated that it would include provisions for the introduction of the CIO in its Charities Bill. It proposed to review the need for other legal forms 5 years after the introduction of the CIO.

2.19 As noted in the Consultation Paper,²³ Clause 34 and Schedule 7 of the *Charities Bill* now make provision for a CIO.²⁴ The CIO is the first legal form to be created specifically to meet the needs of charities. Its purpose is to avoid the need for charities which wish to benefit from incorporation to

²⁰ *Modern Company Law for a Competitive Economy: Final Report* paragraph 4.63 ff. 26 July 2001.

²¹ *Private Action, Public Benefit* at 58.

²² <http://www.homeoffice.gov.uk/>

²³ See the Consultation Paper at paragraphs 3.17 to 3.20.

²⁴ Charities Bill [HL](213) - the most recent version of the Bill can be found at www.publications.parliament.uk

register as companies and be liable to dual regulation by Companies House as well as the Charity Commission. The Bill contains detailed provisions in relation to the form and features of the new CIO.

2.20 The main features are:

- a CIO must be a body corporate with a constitution (in a specified form) with one or more members with no or limited liability;
- any one or more persons may apply to the Charity Commission for a CIO to be constituted and for its registration as a charity;
- a charitable company or a registered industrial and provident society (except for a company or society which has a share capital not fully paid up, or which is an exempt charity) may apply to the Charity Commission for conversion into a CIO;
- any two or more CIOs may apply to the Charity Commission to be amalgamated;
- a CIO may, subject to approval by the Charity Commission, transfer all its property, rights and liabilities to another CIO;
- the Secretary of State may make regulations about the winding up, insolvency, dissolution, and revival and restoration to the register following dissolution, of CIOs.

2.21 In addition, the *Charities Bill* provides:

- that a CIO may do anything which is calculated to further its purposes and gives the CIO's charity trustees the responsibility of managing its affairs;
- that, in general but with some limitations, the validity of acts done by a CIO may not be called into question on the ground that the CIO lacked constitutional capacity;
- that members of a CIO and CIO charity trustees must, subject to regulations made by the Secretary of State, act in the way most likely to further the purposes of the CIO and, in the case of trustees, to exercise reasonable care and skill;
- that CIO charity trustees are prohibited from benefiting personally in certain circumstances from arrangements or transactions entered into by the CIO;
- that a CIO may amend its constitution and specifies the circumstances in which it may do so. The CIO must send the

Charity Commission a copy of the amendment and the Commission may refuse to register it in certain circumstances.²⁵

2.22 At the time of writing, the *Charities Bill* has completed its passage through the House of Lords and has now moved to the House of Commons. It received a Second Reading in the House of Commons on 26 June 2006 and went to committee stage in July 2006. The Bill is expected to receive Royal Assent in Autumn 2006.

(3) Scotland

2.23 The *Charities and Trustee Investment (Scotland) Act 2005* was enacted on 14 July 2005.²⁶ The 2005 Act contains provisions for Scottish Charitable Incorporated Organisations (SCIOs). These provisions are similar to the proposals for a Charitable Incorporated Organisation (CIO) to be introduced in England and Wales. The SCIOs are an optional new structure and will be regulated by the Office of the Scottish Charity Regulator (OSCR).²⁷ Chapter 7 of the 2005 Act (sections 49 - 64), which deals with SCIOs, has not yet come into force.

(4) Northern Ireland

2.24 In Northern Ireland, the Department for Social Development published a *Consultation on the Review of Charities Administration and Legislation in Northern Ireland* in 2005.²⁸ The aim of the proposals is to introduce an integrated system of registration and regulation (including control of charitable fund-raising) as well as supervision and support of registered charities.

2.25 In the Consultation Paper, the Department proposed a new type of organisation, equivalent to the CIO to be introduced in England and Wales and the SCIO in Scotland. The Northern Ireland Council for Voluntary Action²⁹ (NICVA) welcomed the proposed introduction of the CIO as a specific legal structure for charities similar in some ways to a limited company offering protection to trustees from personal liability without the need for dual registration with company and charity law.

2.26 As part of the consultation process, the Department cohosted various workshops with NICVA to discuss key proposals such as the

²⁵ See Schedule 7 to the Bill.

²⁶ <http://www.opsi.gov.uk/legislation/scotland/acts2005/20050010.htm>
3 Commencement Orders have been signed bringing the bulk of the Act into operation.

²⁷ See www.oscr.co.uk

²⁸ http://www.dsdni.gov.uk/charities_consultation.doc

²⁹ The umbrella body for the voluntary and community sector in Northern Ireland.

establishment of a Charity Commission for Northern Ireland, the establishment of a Register of Charities, the provision of a statutory definition of “charity” and “charitable purposes” and to provide for a new form of charitable body (a charitable incorporated organisation). It was unanimously agreed that a Charity Commission and Register of Charities is needed in Northern Ireland, but a note of caution was also sounded that the new body and subsequent regulations would not be too onerous for charities to comply with.

2.27 A further consultation on draft primary legislation – a proposal for an Order in Council, the *Charities (Northern Ireland) Order 2006* was published by the Department for Social Development on 17 July 2006. The proposed draft Order follows the approach taken in England and Wales by proposing to establish the CIO as a new legal entity for charities.³⁰ The purpose of this new form is to avoid the need for charities that wish to benefit from incorporation to register as companies and, thereby, be liable for dual regulation. Again NICVA has welcomed the proposed CIO as a positive development for charities.

(5) *The European Dimension*

2.28 The importance to the European economy and society of co-operatives, mutual societies, associations, foundations and social enterprises (which together are sometimes referred to as the social economy) is now receiving greater recognition in Member States and at European level. The Commission’s Consultation Paper noted that a draft proposal for a Regulation on the Statute for a European Association (EA)³¹ had been advanced to enable associations to take advantage of the single market in the same way as companies can. Once constituted, it was hoped that the EA would simplify the rules for organisations that operate across borders and eliminate administrative difficulties in relation to cross border transactions. The European Commission’s recent decision to withdraw its proposal on the draft Statute for a European Association and European Mutual Society has caused widespread controversy.³² The European Parliament strongly deplores the decision and has called on the Commission to submit new

³⁰ Part XI, Articles 106 to 122 and Schedule 7.

³¹ In 1992 the Commission presented 3 proposals for Statutes for the creation of a European Co-operative, European Mutual Society and European Association (Official Journal no. C 99 of 21/04/92). They were amended in 1993 in the light of opinions of the Parliament and Economic and Social Committee (OJ no. C 236 of 31/08/93, pp. 1-56).

³² Official Journal C64/49 17 March 2006 – Notice No. (2006/C 64/03).

proposals for statutes for European associations and European mutual Societies.³³

2.29 The European Commission has also emphasised the need for higher standards of transparency and accountability on the part of non-profit organisations. It is particularly concerned about the vulnerability of the non-profit sector to terrorist financing and other forms of criminal abuse. The Commission issued a *Draft Recommendation to Member States regarding a Code of Conduct for Non-Profit Organisations* to promote transparency and accountability best practices.³⁴ The recommendation was designed to implement the Financial Action Task Force Recommendation VIII in relation to non-profit organisations. Recommendation VIII states that:

“Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:

- (i) by terrorist organisations posing as legitimate entities;
- (ii) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and
- (iii) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.”³⁵

2.30 Following a period of consultation with Member States and the non-profit sector, the Commission published new guidelines on 29 November 2005.³⁶ The Commission emphasises that the Recommendation and the Framework for a Code of Conduct should not in any way hinder legal cross border activities of non-profit organisations. The aim of a European approach is thus to establish common principles on which national implementation can be based. In relation to oversight of the non-profit sector it is recommended that bodies that have oversight of the non-profit sector, or a part of it, should ensure efficient national cooperation. In this role one of the recommendations is that regulatory bodies should identify existing requirements on non-profit organisations to avoid duplication of registration/reporting obligations.

³³ 4 July 2006.

³⁴ 22 July 2005.

³⁵ See www.fatf-gafi.org

³⁶ *Recommendation for Member States and a Framework for a Code of Conduct for NPOs to Enhance Transparency and Accountability in the Non-profit Sector to Prevent Terrorist Financing and other Types of Criminal Abuse - COM(2005) 620 final.*

2.31 Apart from these developments, it should be noted that there are continuing doubts about whether EU Company Law Directives apply to charitable companies or might do so in the future.³⁷ Article 48 of the EC Treaty provides that Company Law Directives should not apply to not-for-profit bodies, but there is unresolved ambiguity about whether not-for-profit bodies, incorporated under a regime which also allows for the incorporation of commercial bodies, and has no lock on their re-constituting as commercial bodies, are exempt from the provisions of Company Law Directives. If charitable companies do come within the remit of EU Company Law Directives they may be affected by many of the changes inspired by EC law which may have been formulated without regard to the needs and requirements of charitable companies which are very much a minority. These types of ambiguities lend further support to the need for a separate legal structure for charities.

2.32 The Commission is of the view that the availability of a CIO structure in Ireland would be of benefit to charities wishing to operate on a pan-European basis. The main advantage would be the CIOs clear distinction from the company structure. Harmonisation of the rules relating to company law and corporate governance across the EU is becoming an ever increasing feature and it may be of benefit to charities to maintain a distinction from the company structure and to emphasise their status as non-profit organisations. The emergence of CIOs in other jurisdictions may also make it more difficult for charities wishing to operate on a cross jurisdictional basis.

(6) Cross Jurisdictional Issues

2.33 In light of the introduction of Charitable Incorporated Organisations (CIOs) in England and Wales, Scotland and Northern Ireland, the Commission considers that from a cross-jurisdictional point of view there may be benefits in having a similar structure in Ireland. This would facilitate the mutual recognition of charities and assist charities which are currently operating in a number of different jurisdictions. This would also facilitate the concerns expressed at EU level concerning the potential for misuse of charitable and voluntary organisations, in particular in terms of money laundering.

2.34 Submissions received in response to the Commission's Consultation Paper also recognised the attractiveness of being able to adopt a structure which would be transparent in administration and accountability and capable of accommodating cross border charitable activity in a straightforward way.

³⁷ See *Private Action, Public Benefit: Charitable Incorporated Organisation* Prime Minister's Strategy Unit September 2002.

2.35 Given that the existing legal structures being used by charities in Ireland are similar to those in England and Scotland, the experience and developments in those jurisdictions is of considerable assistance in informing the current Irish position. As noted earlier, the Commission considers that, given the development of CIOs in the English, Scottish and Northern Ireland jurisdictions, the introduction of a similar structure in Ireland should not necessarily unduly hold up the progress of the general reform of charity regulation in this State. The Commission considers that the features of CIOs in other jurisdictions should be used to inform the position in Ireland and to ensure that a CIO structure can be introduced without undue delay.

2.36 On a more general note, the Commission welcomes the provision in the draft *Charities Bill 2006* which empowers the Charities Regulator to enter into arrangements for administrative non-binding co-operation with foreign statutory regulatory bodies.³⁸ Many charities' activities now transcend national boundaries and it will be important for the new Charities Regulator to build and maintain strong links with other charity regulators such as the Charity Commission in England and Wales, the Office of the Scottish Regulator in Scotland (OSCR) and the proposed Charity Commission for Northern Ireland.

E The need for a New Legal Structure for Charities in Ireland

(1) Present Position

2.37 As noted earlier, charities in Ireland currently operate under various different legal structures and each of these structures has a separate body of law governing its operation. The traditional legal structures used by charities are the charitable trust, the unincorporated association or the company – usually a company limited by guarantee.³⁹ Charitable trusts are subject to general trust law, unincorporated associations are subject to general contract law and charitable companies are subject to company law. Each structure is also subject to the law in respect of charities.

2.38 Each of the current legal structures available to charities comes with its own advantages and disadvantages and these were outlined in the Consultation Paper. The main distinction lies between the incorporated (companies) and the unincorporated (trusts and associations) forms of charities. Charitable companies sit somewhat uncomfortably between charity law, based on trust law, and company law which was designed

³⁸ Head 40 of the draft *Charities Bill 2006*.

³⁹ There are also other charitable bodies such as societies incorporated by charter (for example, the Royal College of Surgeons in Ireland), or created by statute or under other legislation (such as the industrial and provident societies legislation).

primarily for commercial organisations. On the other hand, incorporation offers the comfort of limited liability which is not available in the case of trusts and unincorporated associations.

2.39 In making its proposals on a new legal structure for charities, the Commission would like to emphasise that it does not question or deem inappropriate, in any way, the choices currently adopted by organisations in order to seek recognition for charitable purposes or to be recognised as being a charitable body.

(2) Consultation Paper

2.40 In the Consultation Paper, the Commission considered that the advantages of introducing a separate legal structure for charities – the Charitable Incorporated Organisation (CIO) – are most acutely highlighted by contrasting it with the main corporate format currently used by charities, the company limited by guarantee. The principal reason why charities opt for incorporation is to avail of the protection afforded by limited liability and also because certain grants are only available to incorporated organisations.⁴⁰

2.41 The Commission noted that companies were not designed to cater for not-for-profit organisations, in fact, quite the opposite. Companies were designed as structures to cater for entrepreneurial activity and to meet the needs of commercial businesses. They generally operate to earn profits for their shareholders. By contrast, the ethos of charities is radically different. Charities exist to carry out a particular purpose and not to make a profit for their members.⁴¹

(3) Discussion

(a) General

2.42 Charitable companies are subject to the *Companies Acts 1963 to 2005* and are subject to regulation by the Office of the Director of Corporate Enforcement. The advent of a second legislative code for charities under the proposed Charities Regulator dramatically changes the landscape for charities operating through companies. Each legislative code incorporates comprehensive registration requirements and regulatory provisions of an equivalent nature. The interaction between both sets of legislation requires careful consideration to ensure that neither dual requirements nor omission from the scope of either legislative code occurs.

2.43 The Commission notes that the proposed *Charities (Northern Ireland) Order 2006* contains specific provisions dealing with charitable companies and covers, *inter alia*, such topics as; winding up, alteration of

⁴⁰ See the Consultation Paper at paragraph 4.23.

⁴¹ See the Consultation Paper at paragraph 4.24.

objects clauses, requirement of consent of the Charity Commission and investigation of accounts.⁴² These provisions are similar to those contained in Part VIII of the English *Charities Act 1993* and ensure that the proposed Charity Commission for Northern Ireland will retain control over certain activities of charitable companies.

2.44 The Commission now turns to consider the issue of dual requirements in the context of an overlap between company and charity law under the following headings: registration, filing and regulation.

(b) Registration

2.45 In the Consultation Paper, the Commission noted that charitable companies must currently register with the Companies Registration Office. The Commission was concerned that the proposed advent of a Charities Regulator could lead to the possibility of dual requirements for registration and other administrative requirements such as reporting and filing of accounts in the case of charities operating as companies. The Commission considered that a separate legal structure for charities would eliminate the burden of dual registration and other administrative requirements.

2.46 The draft *Charities Bill 2006* makes registration mandatory for all charities seeking to operate or fundraise within the State.⁴³ As currently drafted, this appears to indicate that registration will be mandatory under both charities legislation and company legislation. Nonetheless, the notes to the draft *Charities Bill 2006* indicate that continuing discussions with the Department of Enterprise, Trade and Employment and the Companies Registration Office will consider the question of avoiding dual registration requirements in the case of a corporate charity.⁴⁴ The Commission supports the importance of pursuing this matter.

2.47 The draft *Charities Bill 2006* envisages that a charity will be required to provide detailed information on registration such as a copy of the charity's constitution and information such as the area of operation, bank details, what activities will be carried out, how funds were raised, the amount of funds raised since the organisation was formed, gross income and financial accounts.⁴⁵ The draft 2006 Bill provides that the Charities Regulator will also determine whether institutions are or are not charities. This leads to the conclusion that charitable companies will have to register with the Charities Regulator in the first instance. It thus appears that what is envisaged is that the registration forms required by the Charities Regulator

⁴² Part X Charitable Companies.

⁴³ Head 50 of the draft *Charities Bill 2006*.

⁴⁴ See notes to Heads 50 and 62.

⁴⁵ Head 49(7) of the draft *Charities Bill 2006*.

may contain sufficient information to satisfy the requirements of the Companies Registration Office.

2.48 The *Companies Acts* do not currently include any provisions exempting companies from the registration process and contain specific provisions in relation to filing of accounts and returns. Because of this the Commission would be concerned that any envisaged liaison may not be sufficient to eliminate dual registration requirements which may impose unnecessary administrative burdens on charities.

(c) Filing Requirements

2.49 One of the functions of the proposed Charities Regulator will be to ensure the public accountability of charities. In this regard, the draft *Charities Bill 2006* contains provisions in relation to:

- the duty to keep accounting records;⁴⁶
- the preparation and submission of a statement of accounts for each financial year;⁴⁷
- the annual audit or examination of charity accounts;⁴⁸
- the preparation and submission of an annual report together with the corresponding accounts;⁴⁹
- the submission of an annual return including such matters as the aims, strategy, objectives and achievements, income and expenditure, and governance of the charity.⁵⁰

2.50 Charity trustees will therefore have a duty to maintain proper accounting records sufficient to show and explain all the transactions of the charity and to prepare a statement of accounts for each financial year of the charity. The draft *Charities Bill 2006* provides that Regulations may be made by the Minister for Community, Rural and Gaeltacht Affairs in relation to the form and contents of the statement of accounts, in line with current standards in the profession. In this regard the Commission notes that the Charities Statement of Recommended Practice (SORP) 2005⁵¹ is the

⁴⁶ Head 56 of the draft *Charities Bill 2006*.

⁴⁷ Head 57 of the draft *Charities Bill 2006*.

⁴⁸ Heads 58 and 59 of the draft *Charities Bill 2006*.

⁴⁹ Head 60 of the draft *Charities Bill 2006*.

⁵⁰ Head 62 of the draft *Charities Bill 2006*.

⁵¹ Issued by the Accounting Standards Board and the Charity Commission in the UK. See also the *Charities (Accounts and Reports) Regulations 2005* (SI 2005 No. 572).

definitive code of best practice for accounting and reporting by charities in the UK.

2.51 The draft *Charities Bill 2006* relating to the preparation of accounts and the auditing or examination of accounts currently envisage that they will not apply to corporate charities.⁵² The notes to the draft 2006 Bill indicate that in the case of corporate charities the *Companies Acts* will instead apply.

2.52 The draft 2006 Bill provides that charities operating as companies will be required to submit an annual report to the Charities Regulator together with a copy of the charity's annual accounts prepared under the *Companies Acts 1963 to 2005* and a copy of the auditors' report on those accounts.⁵³ The annual report will be required to contain a report by the charity trustees on the activities of the charity during the year and other information relating to the charity or to its trustees or officers. The draft 2006 Bill also provides that the Minister may make further regulations concerning annual reports. It is not apparent from the draft 2006 Bill whether the director's report prepared by the directors of a charitable company pursuant to the *Companies Acts* will be sufficient for these purposes.

2.53 Given the diversity in the size of charities and the activities they undertake, the Commission stated in its Consultation Paper that it would be appropriate for the Charities Regulator to set different annual return and audit requirements depending on the size of the charity involved.⁵⁴ This is reflected in the draft *Charities Bill 2006*,⁵⁵ although the specific monetary amounts have not yet been specified. Under current company legislation, companies limited by guarantee and not having a share capital must file a full set of accounts and cannot avail of the facility available to small and medium sized companies whereby abridged accounts may be filed. This has the potential to raise anomalies between charitable companies governed by companies legislation and unincorporated charities who may be in a position to simply file a receipts and payments account and a statement of assets and liabilities instead of a statement of accounts.⁵⁶ Similar issues may arise in relation to audit thresholds.⁵⁷

⁵² Head 57(7) and Head 58(9) of the draft *Charities Bill 2006*.

⁵³ Head 60(5) of the draft *Charities Bill 2006*.

⁵⁴ See the Consultation Paper at paragraph 4.54.

⁵⁵ See Heads 57(3) and 58(1) and (8) of the draft *Charities Bill 2006*.

⁵⁶ Head 57(3) of the draft *Charities Bill 2006*.

⁵⁷ Head 58(1) and (8) of the draft *Charities Bill 2006*.

2.54 The draft *Charities (Northern Ireland) Order 2006* proposes to amend the *Companies (Northern Ireland) Order 1986* to ensure that the monetary amounts governing the circumstances in which a charitable company's accounts may be subject to an accountant's report instead of an audit are aligned with the monetary amounts specified for other charities.⁵⁸

2.55 The Commission acknowledges that charities established under the Commission's proposed CIO structure should not be subject to less rigorous standards than would apply if they were established as companies. The Commission considers that the submission of an annual return to the Charities Regulator will enhance the public accountability of charities. As to the requirement to file an annual return, the notes to the draft *Charities Bill 2006* also indicate that provision would be made during the formal legislative drafting stage to ensure that charities limited by guarantee will not be subject to dual filing requirements, that is, with the Charities Regulator and the Companies Registration Office.⁵⁹

2.56 The Charities Regulator will also have the power to dispense with the requirement of an annual return in the case of small charities.⁶⁰ The Commission notes that all companies limited by guarantee must file a full annual return regardless of their size. The Commission is generally of the view that it is inappropriate that different standards of financial reporting should apply depending on the legal vehicle used to establish a charity.

(d) Regulation

2.57 In the Consultation Paper, the Commission expressed some concern that the directors of a charitable company may be personally liable under the fraudulent or reckless trading provisions of the *Companies Acts 1963 to 2005*⁶¹ even though acting in a purely voluntary capacity. If the proposed Charities Regulator is responsible for the regulation of all charities this may lead to dual regulation in the case of charities operating through companies. Alternatively, there may be two different regulatory regimes.

2.58 It appears from the draft *Charities Bill 2006* that the Charities Regulator's power in relation to inquiries⁶² will extend to charities operating

⁵⁸ Article 105 – it is proposed to bring down the threshold for an accountant's report from £250,000 to £100,000 for charitable companies.

⁵⁹ See notes to Head 62 of the draft *Charities Bill 2006*.

⁶⁰ Head 62(4) of the draft *Charities Bill 2006*.

⁶¹ These regulatory oversight provisions are mainly geared towards commercial activity. For example, section 150(3) *Companies Act 1990* provides that a restricted person may act as a director of a company where the nominal value of the allotted share capital of the company is (i) in the case of a public limited company, at least £250,000 or (ii) in the case of any other company, at least £50,000.

⁶² Heads 63 to 71 of the draft *Charities Bill 2006*.

as companies. In this context, it is difficult to reconcile the role of the Charities Regulator with that of the Director of Corporate Enforcement whose powers extend to the following areas:

- the initiation of fact-finding company investigations;
- the prosecution of persons for suspected breaches of the *Companies Acts 1963 to 2005*;
- the supervision of companies in official and voluntary liquidation and of unliquidated insolvent companies;
- the restriction and disqualification of directors and other company officers;
- the supervision of liquidators and receivers and
- the regulation of undischarged bankrupts acting as company officers.

2.59 It is not clear how certain offences under the draft *Charities Bill 2006* will be dealt with in the case of charitable companies and whether, in certain circumstances, dual penalties may be imposed, one for a breach of charity law and another for a breach of company law.

2.60 It should also be borne in mind that the Charities Regulator will be empowered to apply to the High Court for an order to grant relief to a charity trustee from personal liability for a breach of trust or breach of duty. This will apply where the Charities Regulator is of the view that the charity trustee had acted honestly and reasonably and ought fairly to be excused for the breach of trust or duty.⁶³ This provision relates to a “charity trustee” which would include the director of a charitable company. Company law does not incorporate any such exceptions and any breaches of company law cannot be exonerated in this way.

2.61 The draft *Charities Bill 2006* empowers the Charities Regulator to co-operate on an administrative non-binding basis with other statutory regulatory bodies both within and outside the State.⁶⁴ The Charities Regulator may enter into one or more arrangements for non-binding administrative co-operation (whether in the form of a Memorandum of Understanding or otherwise) with relevant regulators for the purposes of:

- (a) facilitating administrative co-operation between the Charities Regulator and the relevant regulators in the performance of their respective functions in so far as they relate to issues concerning charities or the regulation of charities,

⁶³ Head 109 of the draft *Charities Bill 2006*.

⁶⁴ Heads 39 and 40 of the draft *Charities Bill 2006*.

- (a) avoiding duplication of activities by the Charities Regulator and any of the relevant regulators,
- (a) ensuring, as far as practicable, consistency between decisions made or steps taken by the Charities Regulator and the relevant regulators in so far as any part of those decisions or steps consists of or relates to a determination of any issues concerning charities or the regulation of charities.⁶⁵

2.62 The draft *Charities Bill 2006* also makes provision for the disclosure of information including, in certain circumstances confidential information, by the Charities Regulator to the Director of Corporate Enforcement. The Charities Regulator is required to report, *inter alia*, to the Director any information which leads the Charities Regulator to believe that a criminal offence may have been committed by a charity or that a charity may have contravened a provision of the *Companies Acts*.⁶⁶ The Charities Regulator may also disclose confidential information to the Director for the purposes of any investigation under Part II of the *Companies Act 1990*, as amended.⁶⁷

2.63 While these provisions clearly allow for co-operation between the Charities Regulator and the Director of Corporate Enforcement, the Commission considers that having two regulatory systems involved in monitoring the charities sector will lead to a lack of clarity amongst the sector, may lead to duplication of effort and resources and may be unnecessarily burdensome for charities. In the Commission's view, the Charities Regulator will, in time, build up a significant bank of knowledge and expertise and would seem to be best placed to deal fully with the regulation of all charities, including charitable companies.

(e) Charitable Trusts and Unincorporated Associations

2.64 Apart from providing an alternative to incorporation as a company, the Commission considered in its Consultation Paper that a new legal structure for charities may also compare favourably with the other main structures currently in use, that is, the charitable trust and the unincorporated association. Neither of these structures confers limited liability on the trustees or officers of the charity.

2.65 As noted earlier, the draft *Charities Bill 2006* incorporates a provision whereby the Charities Regulator may apply to the High Court for an order to grant relief to a charity trustee from personal liability for a breach of trust or breach of duty where the Charities Regulator was of the view that

⁶⁵ Head 39(2) of the draft *Charities Bill 2006*.

⁶⁶ Head 34(2) of the draft *Charities Bill 2006*.

⁶⁷ Head 34(5) of the draft *Charities Bill 2006*.

the charity trustee had acted honestly and reasonably and ought fairly to be excused for the breach of trust or duty.⁶⁸

2.66 It has been suggested that this new provision obviates the need for any new legal structure which would afford limited liability to trustees or officers. The Commission accepts that while, in some circumstances, trustees or officers may be absolved for breaches of duty, there is no guarantee of such an outcome and trustees or officers may still find themselves personally liable to the charitable fund. This provision will, it must be assumed, only operate in exceptional circumstances as a default measure and would not compensate for the lack of the protection afforded by limited liability. To avail of this provision would also involve an expensive application to court. The Commission is therefore of the view that such a provision does not adequately address the concerns which have been expressed in relation to the potential personal liability of charity trustees and the extent to which this may discourage suitable individuals from participating in the management of charities.

(4) Submissions

2.67 Many of the submissions received by the Commission in relation to the Consultation Paper expressly welcomed and supported the introduction of a new legal structure for charities. It was recognised that there is a clear need for charities to have access to a legal structure which suits their needs and is specifically designed for them with appropriate reporting mechanisms, checks and balances. The inappropriateness of the current incorporated structure available to charities (the company limited by guarantee) was recognised and the significant costs associated with filing audited financial statements with the Companies Registration Office and other ongoing compliance requirements was also highlighted.

2.68 There was also a general consensus that the proposed CIOs should report to and be regulated solely by the Charities Regulator. The Commission concurs with this view that the proposed CIOs should be governed by the new charity legislation and not by company law and should be subject to regulation solely by the Charities Regulator. The Commission notes that these submissions are consistent with developments in other jurisdictions which have addressed this matter in recent years. It is also worth noting that this widespread view from the charities sector was not known to the Department of Community, Rural and Gaeltacht Affairs when it published the draft *Charities Bill 2006* in early 2006. The Department's Consultation Paper⁶⁹ did not directly address the issue of legal structures for charities. The Department's Consultation Paper considered that the

⁶⁸ Head 109 of the draft *Charities Bill 2006*.

⁶⁹ *Establishing a Modern Statutory Framework for Charities*.

development of a new legal structure for charities was an issue to be considered as part of the Company Law Review Group's process.⁷⁰ However, it is now clear that the new Companies Bill will not incorporate any provision for a new charitable designated activity company as envisaged in the Department's Consultation Paper.⁷¹

(5) Report Recommendation

2.69 Having considered all of these matters, the Commission sees no reason to depart from its original recommendation that a new form of legal structure a Charitable Incorporated Organisation (CIO) be introduced for charities. The CIO should be governed by the new charity legislation and not by company law and should be subject to regulation solely by the Charities Regulator.

2.70 *The Commission recommends the introduction of a new form of legal structure for charities, to be called the Charitable Incorporated Organisation (CIO). The CIO should be governed by the new charity legislation and not by company law and should be subject to regulation solely by the Charities Regulator.*

F Timing of the Introduction of CIOs

2.71 In the Consultation Paper, the Commission concluded that it would be preferable if the issue of the appropriate legal structure for charities was dealt with in tandem with the proposed legislation on the regulation of charities. The Commission remains of the view that provisions for the introduction of a new CIO structure should be included with the provisions for the new regulatory regime and incorporated in the forthcoming Charities Bill that will follow from the draft Scheme of the Charities Bill 2006.

2.72 However, the Commission recognises that the proposed Charities Regulator will only become operational when the proposed Charities Bill is enacted. In this respect, the Commission has concluded that, the commencement of the relevant provisions dealing with CIOs should be postponed to allow the new Charities Regulator an opportunity to become established and put in place a proper regulatory regime. In the Commission's view, this postponement would be for a relatively short period.

2.73 *The Commission recommends that the introduction of a new CIO structure should be incorporated in the forthcoming Charities Bill. The*

⁷⁰ *Establishing a Modern Statutory Framework for Charities* at 17.

⁷¹ See further at paragraphs 2.74 to 2.82.

commencement of the relevant provisions dealing with CIOs could be postponed to allow the new Charities Regulator an opportunity to become established.

G Should the proposed CIO structure be confined to charities?

2.74 Apart from charities, the not-for-profit sector includes many other community and social enterprise groups. These bodies may also suffer the same problems as charities in relation to the suitability of current corporate structures. The question therefore arises as to whether any new legal structure for charities should also be available to other not-for-profit bodies.

2.75 The Consultation Paper dealt only with organisations set up for charitable purposes and the Commission confined itself to consideration of the appropriate legal structures for charities. The Commission considered that the need for a separate legal structure for other not-for-profit organisations may also require consideration in the future and, in this regard, noted that the Company Law Review Group has recommended that there should be a new legal vehicle for bodies wishing to maintain clearly defined objects known as designated activity companies (DACs).⁷²

2.76 Since the Law Reform Commission's Consultation Paper was published, the Company Law Review Group has published some of the heads of a new Companies Bill which relate to DACs.⁷³ The main provisions are as follows:

- A DAC is to be a private company limited by shares or a private company limited by guarantee and having a share capital with the capacity, including the power, to do only those acts or things set out in its constitution;
- The constitution of a DAC will be in the form of a memorandum and articles of association;
- The legislation would allow for single member companies and the maximum number of members would be 99;
- There is a requirement that all DACs must have two directors. By way of contrast, companies limited by shares need only have one director;
- Unlike the provisions relating to companies limited by shares, a DAC must have an objects clause in its constitution (memorandum and articles of association);

⁷² *Company Law Review Group Second Report 2002-2003.*

⁷³ See www.clrg.ie

- A DAC would have the capacity to do any act or thing stated in the objects set out in its constitution;
- Notwithstanding that a DAC must have an objects clause, protection for creditors and shareholders would be included. The directors of a DAC could be held liable for *ultra vires* actions of the DAC in the form of a personal action against the directors. A person dealing with a DAC would not be bound to enquire as to whether a particular activity is *intra vires*. Provision is also made for the ratification (by special resolution) of an act which is beyond the capacity of the DAC. A separate resolution would be required to absolve the directors from any liability arising;
- A charity may apply to dispense with the use of the words “designated activity company” as part of its name.

2.77 In addition to publishing heads for DACs, the Company Law Review Group has published heads for revised companies limited by guarantee (CLG). The following are the main features:

- A CLG may be formed for any lawful purpose by any two or more persons subscribing to a constitution;
- The liability of the members would be limited to such amount as the members have undertaken to contribute to the assets of the CLG in the event of it being wound-up;
- There would be no limitation on the number of members of a CLG;
- The constitution of a CLG would be in the form of a memorandum and articles of association;
- A CLG would have the capacity to do any act or thing stated in the objects set out in its constitution;
- No CLG could be formed with the power to issue share capital and any existing guarantee companies with an issued share capital would, after the transition period, be deemed to be a designated activity company (DAC);
- A CLG must have at least two directors;
- An audit committee would carry out prescribed tasks, such as reviewing annual accounts. There is a “comply or explain” requirement for the audit committee.

2.78 Although the provisions for accounting and reporting requirements of DACs and CLGs are not yet specified, it is clear that for the purposes of accounting and reporting DACs and CLGs will come within the remit of the *Companies Acts* framework. As noted earlier, this may

potentially give rise to dual requirements in the case of charities which choose to operate as companies.

2.79 The notes to the draft *Charities Regulation Bill 2006* indicate that provision would be made during the formal legislative drafting stage to ensure that charities limited by guarantee will not be subject to dual filing requirements. As discussed above, the question of dual filing requirements (to the Companies Registration Office and the Charities Regulator) and dual regulation (by the Director of Corporate Enforcement and the Charities Regulator) contributed to the Commission's recommendation on the introduction of a new form of legal structure for charities.

2.80 It appears that the requirement for a DAC to have a share capital will generally mean that the CLG will continue to be the preferred option for those charities which choose to operate through a company structure. Having considered the proposed provisions in relation to DACs and CLGs, the Commission has concluded that neither structure adequately addresses the difficulties which may be encountered by charities operating through companies particularly in light of the introduction of a new regulatory regime for charities.

2.81 Other not-for-profit organisations will not be required to register with and will not be subject to regulation by the proposed Charities Regulator and therefore the question of dual registration and regulation will not arise for such organisations. The DAC structure appears to be somewhat similar to the Community Interest Company (CIC), a structure available to community and other social enterprises in the UK.⁷⁴ The Commission has not considered in detail the wider issue of the structures available to other not-for-profit bodies and in this Report has confined itself to consideration of the appropriate legal structures for charities. It does appear however that the new DAC structure or the revised CLG structure may adequately provide for the needs of other not-for-profit organisations. The Commission is therefore of the view that the proposed new CIO structure should be confined solely to charities.

2.82 *The Commission recommends that the proposed new CIO structure should be confined solely to charities.*

H The form of the proposed CIO structure

2.83 Drawing on proposals made by a number of bodies in Ireland, including the Law Society, and reform proposals in the 3 jurisdictions in the UK, a number of essential features of CIOs were identified in the Commission's Consultation Paper. In particular it was noted that the

⁷⁴ Part 2 of the *Companies (Audit, Investigations and Community Enterprise) Act 2004* and the *Community Interest Company Regulations 2005*.

Commission's provisions governing the CIO need to be as clear and understandable as possible to a lay person. The CIO would be governed by its constitution which would deal with issues such as: name, objects, powers, appointment and removal of trustees, and the holding of meetings.

2.84 In the Consultation Paper, the Commission recommended the following features for the CIO:

- The proposed CIO structure should provide a separate legal entity for its members;
- There should be a minimum number of 3 charity trustees;
- There should be limited liability for members;
- The proposed CIO structure may be one-tier, where the members act as charity trustees, or two tier for charities with charity trustees and members;
- A model constitution for the CIO should be designed in consultation with the charity sector;
- The charity trustee's duty of care should be consistent with the proposed legislation on the regulation of charities.⁷⁵

2.85 The Commission also recommended that the proposed legislation on the regulation of charities should contain provisions relating to:

- the simple conversion of existing charities to the new format;
- the amalgamation of charities;
- the transfer of property, rights and liabilities to another similar organisation;
- winding-up, insolvency or dissolution;
- the amendment of the constitution of a charity.⁷⁶

2.86 The submissions received by the Commission generally endorsed the approach taken in the Consultation Paper, which as previously noted drew on national and international proposals and, where relevant, legislative implementation of those proposals. Bearing this in mind, the Commission sees no reason to depart from the generality of its approach and therefore confirms the essential elements of those recommendations, including those concerning the Regulation-making powers attending the proposed legislative scheme for the CIO. But, taking into account the submissions received, a

⁷⁵ See the Consultation Paper at paragraph 4.49.

⁷⁶ See the Consultation Paper at paragraph 4.50.

number of matters merit further consideration with a view to formulating the statutory framework for the proposed CIO. These are: the corporate nature of the CIO; the essential elements of the constitution of the CIO; the position of existing incorporated charities who might convert to the CIO (which concerns the issue of a one tier or two tier structure); reporting requirements for the CIO; and third party dealings with the CIO.

2.87 The submissions received sought clarification as to whether the proposed CIO would be a corporate body. The Commission confirms that this was implicit in its recommendation that the proposed CIO would be a separate legal entity, and the Commission incorporates that point of clarification in this Report. As to the constitution of the CIO, the Commission reiterates the importance of setting out a general scheme which would make it clear and understandable to a lay person, and that a model constitution should be designed by the Charities Regulator in consultation with the charities sector. The Commission also recommends that the proposed Charities Bill which will follow from the draft *Charities Bill 2006* should include the general framework for the constitution of a CIO, leaving the details to be set out in Regulations and through the ongoing consultative process in which the Charities Regulator will be involved. This is in line with the approach taken in the reform proposals to date in Ireland and in neighbouring jurisdictions. The Commission therefore recommends that the legislative framework should state that the constitution of a CIO must deal with the following matters: its name and objects, use of the title CIO, eligibility for charity trusteeship, appointment of trustees, CIO powers, use of powers to further its objects and compliance with requirements to be set out in Regulations. The Commission also recommends that, to ensure certainty on the powers of a CIO, this should be supplemented by provisions which confirm that a CIO must use and apply its property in furtherance of its objects and in accordance with its constitution; that a CIO may do anything which will further its objects; and that the CIO charity trustees may exercise all of the powers of a CIO.

2.88 As to the position of existing incorporated charities who might wish to convert the proposed CIO structure, the Commission reiterates its approach in the Consultation Paper that the proposed CIO structure will be optional, not mandatory.⁷⁷ As the Commission has noted, existing incorporated charities have used the structure of the company limited by guarantee. Under the existing statutory scheme for companies limited by guarantee in the *Companies Acts 1963 to 2005*, charities are required to adopt a two tier system which draws a distinction between company members (in effect, the owners) and company directors (in effect, trustees). In the context of a charity, this distinction is, essentially, meaningless, but

⁷⁷ See paragraph 2.102, below.

the Commission acknowledges that existing charities must comply with the current statutory regime. This, of course, is one of the reasons why the Commission, in line with other bodies, has recommended the creation of the charity-specific CIO structure: it would involve a one tier system in which the CIO charity trustees would exercise the functions which company members and company directors currently perform in companies limited by guarantee. Because existing incorporated charities might wish to avail of the proposed CIO structure, the Commission had provisionally recommended in the Consultation Paper that the proposed CIO structure should provide for both a one tier system and a two tier system. The Commission reiterates in this Report the essential basis of this recommendation, namely, to facilitate the conversion of existing incorporated charities. In the context of proposing a clear statutory scheme for the CIO, however, the Commission has concluded that it should recommend that the proposed scheme be drafted on the basis of a one tier system, because this reflects a structure that is true to the nature of a charity, in which the trustees are responsible for ensuring that the charity is administered in accordance with its objects. Because of this, the draft Bill published with this Report contains a one tier structure for a CIO, and does not formally provide for a two tier structure. But, in order to facilitate the conversion of existing incorporated charities, the Commission recommends that the Charities Regulator would be empowered to provide that, on conversion, both the members and directors of a company can be deemed to be charity trustees for the purposes of the CIO structure: not all members and directors would automatically be converted to trusteeship status in this conversion, and this would be a matter for appropriate guidance from the Charities Regulator during the conversion process. The Commission also wishes to emphasise that the CIO one tier system in no way affects existing arrangements within incorporated charities such as the appointment of committees to carry out specified functions on behalf of the charity.

2.89 A fourth point which the Commission considers it is appropriate to discuss arises from submissions which sought clarification as to the type and frequency of reporting by CIOs. As the CIO would be subject to general charity law, the Commission notes that reporting requirements would be identical to that required of all other charities, and that the detail on this is now helpfully contained in the draft *Charities Bill 2006*.

2.90 The final point which the Commission considers merits reference is the position of third parties who deal with a CIO. The reform proposals and legislative schemes in the other jurisdictions to which the Commission has referred provide that a party dealing in good faith with a CIO should not be prevented from pursuing any claim even where it transpires that the CIO has acted in excess of its powers (*ultra vires*). The Commission considers that the manner in which this is dealt with in section 62 of the *Charities and*

Trustee Investment (Scotland) Act 2005 provides a suitable model in this respect. The Commission accordingly recommends that the proposed legislative scheme for the CIO should incorporate a provision on the position of third parties who deal with a CIO based on section 62 of the *Charities and Trustee Investment (Scotland) Act 2005*. In light of these points, the Commission proceeds to set out its final recommendations.

2.91 *The Commission recommends that the legislative scheme for the CIO include the following:*

- *The CIO will be a separate legal entity, that is, a body corporate incorporated under the Charities Bill which will follow from the draft Charities Bill 2006 and entered on the Charities Register;*
- *The CIO must have a constitution and a minimum number of 3 charity trustees;*
- *The constitution of a CIO must deal with the following matters: its name and objects, use of the title CIO, eligibility for charity trusteeship, appointment of trustees, CIO powers, use of powers to further its objects and compliance with requirements to be set out in Regulations;*
- *A model constitution for the CIO should be designed in consultation between the Charities Regulator and the charity sector;*
- *The duty of care of the CIO charity trustees will be as provided for in the draft Charities Bill 2006;*
- *The liability of the charity trustees will be limited in the terms envisaged by the draft Charities Bill 2006, and charity trustees will not be required to contribute to the assets of the CIO on its winding up;*
- *A CIO must use and apply its property in furtherance of its objects and in accordance with its constitution; a CIO may do anything which will further its objects; and the CIO charity trustees may exercise all of the powers of a CIO;*
- *The proposed CIO structure will be one tier, with the charity trustees involved in ensuring that the charity acts in pursuance of its objects, but existing charities which are incorporated as companies limited by guarantee will be facilitated in their conversion to the CIO structure by empowering the Charities Regulator to deem a company member and a company director to be a CIO charity trustee when the conversion is being completed;*

- *The position of third parties who deal with a CIO that may have acted in excess of its powers should be based on section 62 of the Charities and Trustee Investment (Scotland) Act 2005*

2.92 *The Commission recommends that the legislative scheme for the CIO should also provide for Regulation-making power concerning:*

- *The name of a CIO;*
- *The constitution of a CIO, including deviation from any specific requirements;*
- *Amendment of the constitution of a CIO;*
- *The submission of annual accounts of a CIO to the Charities Regulator in an approved manner;*
- *The conversion of existing charities, whether unincorporated or incorporated, to the CIO structure in the simplest and most cost-effective manner;*
- *The amalgamation of existing charities or CIOs;*
- *The transfer of property, rights and liabilities from a CIO or charity to a similar body;*
- *Winding-up, insolvency or dissolution of a CIO, including directions regarding the application of the property of a CIO in the event of the CIO being wound up.*

I The Proposed CIO as Optional or Mandatory?

2.93 In the Consultation Paper the Commission considered whether the proposed CIO should be available as an additional option to existing methods of creating a charity - whether by way of a trust or by any form of incorporation - or should be mandatory.⁷⁸

2.94 The Commission acknowledged that it would not be feasible to prevent charities from setting up as trusts, as unincorporated associations or by an incorporated means such as an industrial and provident society or company limited by guarantee. Many existing charities constituted as trusts or unincorporated associations might benefit from a more structured constitution, and more certainty about the powers and duties of their trustees and members in addition to the protection afforded by limited liability status. In many instances trusts and unincorporated associations are compelled into a corporate structure if they wish to avail of grants and funding. The Commission therefore concluded that it would be preferable, certainly in the immediate future, that the proposed CIO structure should be available as an optional structure for existing charities. The Commission considered that existing charitable trusts and unincorporated associations should have the option of converting to the proposed CIO structure without incurring any excessive costs or inconvenience. Similar considerations apply to industrial and provident societies. The Commission sees no reason to depart from this view, which is, of course, subject to the proviso that this is achieved in a manner consistent with the general purposes of the Charities Bill which will follow from the publication of the draft *Charities Bill 2006*.

2.95 *The Commission recommends that existing charitable trusts, unincorporated associations or industrial and provident societies should be given the option of converting to the proposed CIO structure and that the conversion should be capable of being achieved in a simple, cost effective, manner, consistent with the general purposes of the Charities Bill which will follow from the publication of the draft Charities Bill 2006.*

2.96 As regards charities registered as companies under the *Companies Acts* the Commission considered 3 scenarios:

- All existing incorporated charities would be obliged to convert to the new structure and new charities wishing to incorporate would only be allowed to use the new structure;
- Existing incorporated charities would be given the *option* of converting to the new structure but the new structure would be mandatory for new charities wishing to incorporate;

⁷⁸ See the Consultation Paper at paragraphs 4.56 to 4.67.

- Existing incorporated charities would be given the option of converting to the new structure and new charities would also have the option of choosing the new structure or other legal status.

2.97 As regards the first option, while it might be legally possible to prevent new charities from incorporating under the *Companies Acts*, the Commission accepts that it might prove more difficult to require conversion of existing companies. For those charities which do not convert to the new structure, the disadvantages may include dual filing requirements. Requiring existing charities to convert to the new structure might entail some additional costs and upheaval for charities which are well established in their existing categories. However, as noted above the Commission is of the view that conversion should be capable of being achieved in a simple cost effective manner.

2.98 As regards the second option, it could be regarded as inequitable to allow existing charities the option of converting to the new structure while denying new charities the option of using existing structures. The spectre of some form of “unofficial charities” would be unacceptable.

2.99 It appeared to the Commission that, at least at the outset, the third option would be the most appropriate course of action. As with any new legal entity it may take some time for the new type of structure to “settle down” and some adjustments may be required before a final workable format is in operation. It might also be considered contrary to the ethos of the voluntary sector to introduce the notion of compulsion into the internal organisation of charities. For these reasons the Commission concluded that it would not be appropriate to insist from the beginning that all incorporated charities adopt the new format.

2.100 The submissions received by the Commission in response to the Consultation Paper were in favour of retaining the continued use of existing established legal structures by both existing and new charitable bodies. It was recognised for example that the charity sector is a very diverse one both in terms of the size of organisations and purposes and that many larger charities may wish to continue operating as companies limited by guarantee. On the other hand, many charities start from very small beginnings, for example, by raising money for a particular purpose and holding it on trust.

2.101 The Commission therefore confirms the view it took in the Consultation Paper that the CIO should be an additional legal form for charities and that a charity’s ability to use any other of the legal forms available should not be restricted. If the proposed DAC and CLG⁷⁹ fall into disuse as a result of the introduction of the CIO then there may be a case for ultimately withdrawing the other options currently available.

⁷⁹ See paragraphs 2.76 and 2.77 above.

2.102 *The Commission recommends that the proposed CIO structure should be an additional option for incorporated charities and that the other existing methods of incorporation should continue to be available.*

J Review

2.103 The draft *Charities Bill 2006* provides that a review of the operation and effect of the new legislative scheme will be undertaken after 5 years in operation. In the Commission's view this would also appear to be a reasonable period for the review of the operation of the proposed CIO structure. While some of the submissions on the Consultation Paper suggested a shorter review period, the Commission remains of the view that a period of 5 years would be required to allow the system time to develop fully. This period could be used as an opportunity to consult with the charity sector including exploring whether or not the CIO structure should be made compulsory for any charities wishing to incorporate. In addition, if any significant issues arose within the 5 year period these could be addressed by the Charities Regulator.

2.104 *The Commission recommends that the operation of the proposed CIO structure should be reviewed after a period of 5 years from its introduction, at which point consideration may be given to whether other methods of incorporation for charities should continue to be available.*

K Charitable Companies other than CIOs

2.105 The discussion to this point centres on the introduction of a new legal structure for charities, the CIO. However, the issues discussed concerning dual registration, filing and regulation also arise for those charities that choose to continue operating as charitable companies, either as companies limited by guarantee or designated activity companies, without converting to the proposed CIO structure. The question is where those charities fit into the proposed new registration and regulatory regime for charities?

2.106 It is clear that charitable companies will not be totally exempted from the provisions of the new regulatory system, although some specific exemptions may be made in relation to certain aspects, such as the accounting provisions. The draft *Charities Bill 2006* defines "charity trustees" to include charitable companies. "Charity trustees" are defined as meaning the persons, whether or not officers, having the general control and management of the administration of a charity and includes the directors and other officers of a charity that is established as a company.⁸⁰

⁸⁰ Head 2 of the draft *Charities Bill 2006*.

2.107 The purpose of any system of registration and regulation is to ensure compliance with specific legislative provisions thereby promoting transparency and securing accountability. As noted earlier, the existing company law code and the proposed charity legislation both incorporate comprehensive registration requirements and regulatory provisions which are equally capable of monitoring charitable companies. The Commission is of the view that the success of any such system of registration and regulation depends to a large extent on the ability of those persons charged with meeting the requirements to fully understand what is required of them. The existence of two separate registration and regulatory regimes for different parts of the same sector can only serve to confuse those persons charged with ensuring compliance with each regime, in this case charity trustees. It is essential that charity trustees are fully aware of their legal responsibilities, and requiring them to comply with two extensive pieces of legislation appears to be burdensome to say the least.

2.108 The Commission reiterates in this respect that the very essence of charity is that it is voluntary. All charities are ultimately the responsibility of voluntary trustees who give freely of their time and effort. The responses to the Department's consultation process clearly accepted the need for accountability and the requirement for regulation of the charity sector. However, key concerns were expressed about the proportionality of any new measures. The Commission similarly endorses the need for accountability and regulation of the charity sector but that any measures must be proportionate to the aims sought to be achieved.

2.109 If charitable companies are required to register with and are regulated by the Charities Regulator the question arises as to whether they should also comply with the *Companies Acts* regime.

2.110 The purpose of registration and filing of accounts and annual returns with the Companies Registrar is to provide for transparency and accountability. The basis of these requirements is that the public should have access to the details of the ownership, finances and officers of companies granted the privilege of incorporation. But if all of this information were supplied to the Charities Regulator would members of the public be disadvantaged in any way? In this regard, it is noted that the draft *Charities Bill 2006* provides that a body entered in the register *may* refer to itself as a "charity", a registered charity", a "charity registered in Ireland", an "Irish charity" or a "registered Irish charity".⁸¹ If the requirement to identify a body as a charity was made mandatory, for example, on all letterheads, then members of the public would be aware that they were dealing with a charity. If members of the public required information about a charitable company they may carry out a search at the Office of the Charities Regulator

⁸¹ Head 53(1) and (2) of the draft *Charities Bill 2006*.

in the same way that they would currently carry out a Companies Registration Office search. For completeness and from an administrative point of view, the Charities Regulator could notify to the Companies Office details of any charitable companies which had registered with it.

2.111 Similarly, in the Commission's view, the investigatory powers of the Charities Regulator⁸² should be sufficient to address any misconduct or mismanagement in the administration of a charitable company. The draft *Charities Bill 2006* empowers the Charity Regulator, arising out of an inspection, investigation or inquiry, to take appropriate remedial action (such as suspension or removal of trustees, appointment of additional trustees or restrictions on the transactions or payments that can be effected by the charity) without its prior approval.

2.112 The submissions on the Consultation Paper support the view that all charities, regardless of their legal structure, should report to a common regulator.

2.113 The Commission accepts that it may not be practical to exempt charitable companies from all company legislation and confines its recommendations to matters relating to registration, accounts, audit and annual returns, and regulation. In particular the company law provisions in relation to winding-up would continue to apply to charitable companies.

2.114 The Commission has concluded that, as regards registration, accounts, audit and annual returns and regulation, all charities, regardless of their legal structure, should be subject to overview by the Charities Regulator only.

2.115 The Commission recommends that, as regards registration, accounts, audit and annual returns and regulation (but only these matters), all charities, regardless of their legal structure, should be subject to overview by the Charities Regulator only.

⁸² Heads 63 to 71 of the draft *Charities Bill 2006*.

CHAPTER 3 CHARITIES AND TRADING ACTIVITIES

A Introduction

3.01 Many charities carry on trades, either as part of their charitable activities or to raise funds and it is clear that trading is an important activity for many charities. In the Consultation Paper, the Commission briefly addressed the topic of trading in considering whether charities carrying on trading activities should be able to avail of the proposed CIO structure. The submissions on the Consultation Paper raised a number of issues in relation to the question of trading by charities and generally indicated that greater clarity in this area would be welcomed. The Commission therefore turns to explore this issue in more depth in response to those submissions.

B General Principles

3.02 The difficulties encountered in relation to trading by charities are twofold. First, the effect on the charity's charitable status and, secondly, the tax implications of trading. It is a principle of charity law that a charity set up wholly and exclusively for charitable purposes will apply its funds solely for those purposes. There is an expectation that contributions made to a charity will be used for its purposes or invested prudently and not risked on trading activities undertaken to raise money.

3.03 Some charities assume that the profits arising from trading activities are not taxable simply because the profits from trading are used for charitable purposes. This is a common myth which can give rise to difficulties for charity trustees. The following general principles should be noted:

- A charity cannot claim that it is not trading simply because it is not a commercial organisation;
- Where operations carried on have the characteristics of a business, then any profit made will be a trading profit;
- Whether a profit is sought or not, if a profit emerges it can be regarded as a trading profit;

- If the charity carries on activities similar to those being carried on by non-charitable bodies which are accepted as trading, then the charity must also be trading;
- Where goods or services are provided at a full commercial price that will be strong evidence of trading.¹

3.04 It is clear that many charities are now widening the range of their fundraising activities and many are carrying on trading activities as a further means of fundraising for the charity. However, if charities were allowed to carry on unlimited non-primary purpose trading on a tax-exempt basis this could clearly lead to unfair competition with private businesses. Significant trading activity by charities might also bring charitable status into question and possibly damage public confidence in charities.

3.05 The Commission considers that the current trading exemptions discussed in detail below are somewhat restrictive and it is often difficult for charities to fall within the conditions. The Commission acknowledges, however, that any amendments to the tax exemptions available to charities must be implemented by way of Finance Act provisions and not as part of the proposed charity legislation.

C Trading Activity

3.06 There are 3 main types of trading by charities:

- Primary purpose trading, that is, trading in the course of actually carrying out the primary purpose of the charity;
- Ancillary trading, that is, trading linked to and carried out at the same time as carrying out the primary purpose of a charity;
- Non-primary purpose trading, that is, trading with the sole or main aim of raising funds.

3.07 Trading involves the sale of goods or services as part of a commercial activity. Once-off or occasional activities or events may also be regarded as a trade. For the purposes of the Taxes Acts a trade is defined as “any trade, adventure or concern in the nature of a trade”.² Provided certain conditions are met, the profits of a trade carried on by a charity may be exempt from tax.

3.08 Charity law allows charities to exercise a trade in the course of the actual carrying out of a primary purpose of the charity. This chapter is

¹ See *Royal Agricultural Society of England v Wilson (1924) TC 62* and *Brighton College v Marriott (1925) 10 TC 213*.

² Section 2 *Taxes Consolidation Act 1997*.

therefore not concerned with the provision of services which form the primary purpose of the charity, for example, the provision of educational services by a school or the provision of health care services by a hospital.

3.09 Many charities carry on trading activities which are ancillary to their wholly and exclusively charitable objects. The activity must be carried out on a limited or small scale, otherwise it will be treated as the carrying out of a non-charitable purpose.

3.10 Charities which carry on trading activities which are not ancillary to their charitable purposes often have to set up subsidiary trading companies. The subsidiary trading company is not a charity and is fully taxable on its profits. Such companies can however donate their profits to an eligible charity.³ The need to set up separate trading companies often leads to increased costs for charities, for example, in relation to the preparation of accounts.

D Tax Exemption

3.11 Any persons or entity carrying on a trading activity may be liable to income tax or corporation tax on the profits of the trade. Currently, charities can avail of exemption from tax on trading activities if they satisfy the conditions set down in section 208 of the *Taxes Consolidation Act 1997* which requires that the profit of the trade must be applied solely for the purposes of the charity. In addition, one or other of the following conditions must also be satisfied:

- the trade must be exercised in the course of the actual carrying out of a primary purpose of the charity⁴ (an example of this type of arrangement would be a religious organisation selling religious books/magazines, that is, the main object of the organisation is promoting religion and the selling of books/magazines is merely a facility to achieve that object)

or

- the work in connection with the trade must be mainly carried on by beneficiaries of the charity⁵ (an example would be the sale of goods produced by persons with a disability through a shop or mail order catalogue).

3.12 If an organisation applies for tax exemption on trading activities, the first question to be addressed is whether the organisation is a body of

³ Section 848A *Taxes Consolidation Act 1997*.

⁴ Section 208 (2)(b) *Taxes Consolidation Act 1997*.

⁵ Section 208 (2)(b) *Taxes Consolidation Act 1997*.

persons established for charitable purposes only.⁶ It is only when this question has been answered that the trading question is examined under the two conditions outlined above. For example, charity shops solely established to raise funds might not qualify for tax exemption as the primary purpose of the body is the conduct of a trade. However, it must be stressed that the Revenue Commissioners examine each claim on a case-by-case basis and each case is considered on its own merits.

3.13 The type of trading activities could be categorised as follows:

- 1) Trades which form an actual primary purpose of the charity (for example, a religious charity selling religious books in furtherance of its promotion of religion or a hospital providing medical treatment on a fee paying basis, or a school charging fees);
- 2) Trades, where the work in connection with the trade is carried on mainly by beneficiaries of the charity (for example, the manufacture and sale of goods by disabled persons);
- 3) Trades which are ancillary to the primary purpose of the charity but which are either a necessary adjunct thereto or contribute to or improve its delivery, for example, a school or university providing accommodation for students on a fee / rental basis;
- 4) Trades which are neither primary purpose activities nor ancillary to such purposes but which are undertaken specifically to raise funds for the charity, for example, charity shops.

Income arising under the first two categories would be specifically exempted from tax, provided that the profits from such trades are applied solely for the purposes of the charity. Income arising under the third and fourth categories would not generally qualify for tax exemption subject, of course, to the views of the Revenue Commissioners in each particular case.

E Charity Shops

3.14 Charity shops have traditionally been a popular way of raising funds for charities. It is generally accepted by Revenue that the sale of donated goods is not regarded as a trade and the profits from such activity are exempt from tax. On the other hand, the sale of goods bought in for the purpose of sale or the alteration of donated goods may be regarded as a trade. If the donated goods are substantially altered or improved prior to sale then the profits from that sale may be treated as taxable trading income. Generally, trading through charity shops is related to the core activity of the charity and provided the shop is selling donated goods which have not been

⁶ Pursuant to section 207 *Taxes Consolidation Act 1997*.

substantially altered the relevant tax exemption will apply. The profits derived from this form of activity are usually relatively small. This is because of the high costs involved in running these operations. Costs include items such as rent, rates, insurance and, in some instances, where sufficient volunteers are not available, wage costs are also incurred. These shops not only generate funds for charitable purposes, they also benefit the local communities where they are situated. However, evidence from the sector suggests that issues such as increasing costs, health and safety, employment law, insurance issues and ever increasing competition from low price discount stores are leading to a steady decline in activities carried on through charity shops.⁷

F United Kingdom Rules on Trading

3.15 Section 505(1)(e) of the UK *Income and Corporation Tax Act 1988* provides for similar exemption from tax for trading activities to that contained in the Irish 1997 Act. However, the exemption has been further extended in a number of ways.

(1) Small Trading

3.16 A new statutory exemption was introduced from April 2000 which exempts a charity from tax whose trading income is small.⁸ A charity may claim this exemption if its income from trading does not exceed 25% of its gross income from all sources. This exemption is subject to the qualification that the limit can never be less than £5,000 and cannot exceed £50,000. The exemption is lost completely if the charity's gross income exceeds the requisite limit. If a charity's turnover from trading activities exceeds the annual turnover limits, it may still be exempt if the charity can show that, at the start of the tax year, it was reasonable for it to expect that the turnover would not exceed the limit. This exemption saves charities with small amounts of non-purpose trading activities from having to set up a separate subsidiary trading company to carry on the trade.

(2) Fund Raising Activities

3.17 There is also an extra-statutory concession which provides that tax will not be charged on profits derived from certain events arranged by voluntary organisations or charities for the purpose of raising funds for the charity.⁹ The exemption applies to the supply of goods and services by a charity in connection with an event:

⁷ For example, in early 2006, Concern decided to discontinue its retail operations – see Annual Review 2005 at www.concern.net

⁸ Section 46 *Finance Act 2000*.

⁹ Inland Revenue ESC C4 (March 2000).

- (a) that is organised for charitable purposes by a charity or jointly by more than one charity;
- (b) whose primary purpose is the raising of money;
- (c) that is promoted as being primarily for the raising of money.

(3) *Mixed Trades*

3.18 In some cases, a trade may amount, in part, but not wholly, to a primary purpose trade. For example, the trade might offer a range of goods or services, only some of which are within a primary purpose, or the trade might serve some customers who are not beneficiaries or patrons of the charity, as well as those who are. In these circumstances, the trade might not qualify as a primary purpose trade because part of the trade is not related to a primary purpose. HM Revenue & Customs accept that all of the profits of the trade are exempt from tax if:

- the turnover of the part of the trade which is not within a primary purpose is not “large” (that is, not more than £50,000), and
- the turnover of that part of the trade is less than 10% of the turnover of the whole trade.

3.19 Under these rules, tax relief for the whole of the trade may have been lost if a charity's trade was tainted by an element of non-primary purpose or if the trade was partly but not mainly carried on by beneficiaries of the charity. However, by concession, HM Revenue & Customs treated the different elements of the trade as separate trades. Section 56 of the UK *Finance Act 2006* has put this concessionary treatment on a statutory basis and removed the monetary and percentage requirements. Section 56 provides that

(a) where a trade is exercised partly in the course of the actual carrying out of a primary purpose of the charity and partly otherwise, each part shall be treated as a separate trade (for which purpose reasonable apportionment of expenses and receipts shall be made), and

(b) where the work in connection with the trade is carried out partly but not mainly by beneficiaries, the part in connection with which work is carried on by beneficiaries and the other part shall be treated as separate trades (for which purpose reasonable apportionment of expenses and receipts shall be made).

3.20 This new provision will therefore remove the risk that charities with mixed trades that are only partly primary purpose, or are not mainly carried on by the beneficiaries of the charity, could, if the non-charitable part of the trade is large, lose tax relief on the profits of the whole of the trade.

(4) Further Proposals in relation to Charity Trading

3.21 In 2002, the UK Cabinet Office Strategy Unit proposed that charity law should be amended to allow charities to undertake all trading within the charity, without the need for a separate trading company subject to a statutory duty of care. This proposal was rejected by the Government.¹⁰ In effect, this would have involved de-coupling charity law from tax law in relation to trading. The recommendation was that a charity would be able to engage in all trading directly which would make it liable for tax on its trading profits. This would have inevitably led to calls for an amendment of tax legislation to fully exempt charities' trading profits from tax.

3.22 The Cabinet Office proposal was rejected by the Government on the basis that conducting trading activities within the tax exempt structure of charities would offend the principle of a level playing field with private sector businesses.¹¹ The Joint Committee on the Draft Charities Bill considered that further powers to trade were desirable provided there remained some limit to them. The Committee recommended that the existing limit of £50,000 should be higher and that the Government should consult on the level at which the overall limit should be set.¹² In its response, the Government was of the view that any increase in the overall limit would give charities a greater advantage over private sector businesses, especially small and medium sized enterprises. The Government considered that an increased limit would mean that considerably more trading could be carried out by charities tax free, giving them a greater competitive advantage over small businesses which are taxed on their profits.¹³

¹⁰ *Private Action, Public Benefit*, September 2002 at paragraph 4.47.

¹¹ *Charities and Not-for Profits: A Modern Legal Framework*, July 2003 at paragraph 3.34.

¹² *Joint Committee on the Draft Charities Bill – First Report*, 30 September 2004 at paragraphs 353 and 354.

¹³ *The Government Reply to the Report from the Joint Committee on the Draft Charities Bill Session 2003–04*, December 2004 at paragraph 42.

G Submissions

3.23 The submissions on the Consultation Paper highlighted the need for further clarification in relation to trading activities and that the time has come to revisit the existing criteria for tax exemption. The need to set up separate trading companies can give rise to considerable extra costs including professional advice and fees arising from the complex apportionment of costs and the need to keep separate accounts. The issue of charity shops was a common theme and some suggested that charity shops should be specifically excluded from the definition of trading activity as they are essentially fundraising mechanisms for charitable purposes.

H Conclusions

3.24 The Commission has considered the existing rules in relation to the taxation of trading profits of charities and has also reviewed the recent amendments introduced in the United Kingdom.

3.25 As noted above, many charities consider that activities such as trading shops should be excluded from the definition of trading activities as they are essentially fundraising mechanisms for charitable purposes. The Commission is of the view that a blanket tax exemption for charity trading shops would not be appropriate as such an exemption might be open to abuse and might also give charities an unfair advantage over other businesses.

3.26 The Commission appreciates the concerns raised in the submissions particularly the need for further clarity in relation to trading issues. The Commission has however decided against recommending the introduction of specific monetary limits in relation to trading such as those applicable in the United Kingdom. The Commission is of the view that such limits may prove somewhat inflexible and that the existing examination of charity trading activity on a case-by-case basis is more beneficial to charities. The Commission does consider that further clarity could be achieved through the issue of guidelines in relation to trading by the Charities Regulator following consultation with the Revenue Commissioners.

3.27 The Commission recommends that the Charities Regulator should, in conjunction with the Revenue Commissioners, issue guidelines for charities in relation to trading activities.

3.28 In the Consultation Paper, the Commission recommended that charities carrying on trading activities directly related to their charitable purposes should be allowed to avail of the proposed CIO structure.

3.29 The Commission sees no reason to depart from this recommendation and considers that any charity which carries on trading

activities which satisfy the legislative requirements for tax exemption should be allowed to avail of the proposed CIO structure. Of course, where a charity sets up a company for trading purposes which does not satisfy these requirements, it should not be in a position to avail of the proposed CIO structure and would be obliged to register as a company under the *Companies Acts* or avail of some other legal structure.

3.30 The option of creating a CIO specifically to carry on trading activities directly related to charitable purposes might also prove attractive to existing charities already using one of the other legal vehicles for their main charitable activities. The power to set up a separate trading entity must of course be contained in the governing instrument of the charity.

3.31 *The Commission recommends that any charity which carries on trading activities which satisfy the legislative requirements for tax exemption should be allowed to avail of the proposed CIO structure.*

CHAPTER 4 SUMMARY OF RECOMMENDATIONS

4.01 The recommendations made in this Report may be summarised as follows:

Chapter 1 Charity Trustees

4.02 The Commission recommends that a minimum of 3 trustees be required to act for a charitable trust or 3 officers in the case of an unincorporated association. The Commission recommends that where a corporate trustee acts as sole trustee, in such circumstances there should be at least 3 directors on the board of directors. If the numbers fall below 3 and the person or persons having power to appoint new charity trustees are unable or unwilling to do so, the Charities Regulator should have power to appoint additional trustees to bring the numbers back up to the statutory minimum. [Paragraph 1.40]

Chapter 2 Legal Structures for Charities

4.03 The Commission recommends that the general reform of charity regulation should include the issue of the legal structure of charities. [Paragraph 2.12]

4.04 The Commission recommends the introduction of a new form of legal structure for charities, to be called the Charitable Incorporated Organisation (CIO). The CIO should be governed by the new charity legislation and not by company law and should be subject to regulation solely by the Charities Regulator. [Paragraph 2.70]

4.05 The Commission recommends that the introduction of a new CIO structure should be incorporated in the forthcoming Charities Bill. The commencement of the relevant provisions dealing with CIOs could be postponed to allow the new Charities Regulator an opportunity to become established. [Paragraph 2.73]

4.06 The Commission recommends that the proposed new CIO structure should be confined solely to charities. [Paragraph 2.82]

4.07 The Commission recommends that the legislative scheme for the CIO include the following:

- The CIO will be a separate legal entity, that is, a body corporate incorporated under the Charities Bill which will follow from the draft Charities Bill 2006 and entered on the Charities Register;
- The CIO must have a constitution and a minimum number of 3 charity trustees;
- The constitution of a CIO must deal with the following matters: its name and objects, use of the title CIO, eligibility for charity trusteeship, appointment of trustees, CIO powers, use of powers to further its objects and compliance with requirements to be set out in Regulations;
- A model constitution for the CIO should be designed in consultation between the Charities Regulator and the charity sector;
- The duty of care of the CIO charity trustees will be as provided for in the draft Charities Bill 2006;
- The liability of the charity trustees will be limited in the terms envisaged by the draft Charities Bill 2006, and charity trustees will not be required to contribute to the assets of the CIO on its winding up;
- A CIO must use and apply its property in furtherance of its objects and in accordance with its constitution; a CIO may do anything which will further its objects; and the CIO charity trustees may exercise all of the powers of a CIO;
- The proposed CIO structure will be one tier, with the charity trustees involved in ensuring that the charity acts in pursuance of its objects, but existing charities which are incorporated as companies limited by guarantee will be facilitated in their conversion to the CIO structure by empowering the Charities Regulator to deem a company member and a company director to be a CIO charity trustee when the conversion is being completed;
- The position of third parties who deal with a CIO that may have acted in excess of its powers should be based on section 62 of the *Charities and Trustee Investment (Scotland) Act 2005*. [Paragraph 2.91]

4.08 The Commission recommends that the legislative scheme for the CIO should also provide for Regulation-making power concerning:

- The name of a CIO;
- The constitution of a CIO, including deviation from any specific requirements;

- Amendment of the constitution of a CIO;
- The submission of annual accounts of a CIO to the Charities Regulator in an approved manner;
- The conversion of existing charities, whether unincorporated or incorporated, to the CIO structure in the simplest and most cost-effective manner;
- the amalgamation of existing charities or CIOs;
- the transfer of property, rights and liabilities from a CIO or charity to a similar body;
- winding-up, insolvency or dissolution of a CIO, including directions regarding the application of the property of a CIO in the event of the CIO being wound up. [Paragraph 2.92]

4.09 The Commission recommends that existing charitable trusts, unincorporated associations or industrial and provident societies should be given the option of converting to the proposed CIO structure and that the conversion should be capable of being achieved in a simple, cost effective, manner, consistent with the general purposes of the Charities Bill which will follow from the publication of the draft Charities Bill 2006. [Paragraph 2.95]

4.10 The Commission recommends that the proposed CIO structure should be an additional option for incorporated charities and that the other existing methods of incorporation should continue to be available. [Paragraph 2.102]

4.11 The Commission recommends that the operation of the proposed CIO structure should be reviewed after a period of 5 years from its introduction, at which point consideration may be given to whether other methods of incorporation for charities should continue to be available. [Paragraph 2.104]

4.12 The Commission recommends that, as regards registration, accounts, audit and annual returns and regulation (but only these matters), all charities, regardless of their legal structure, should be subject to overview by the Charities Regulator only. [Paragraph 2.115]

Chapter 3 Charities and Trading

4.13 The Commission recommends that the Charities Regulator should, in conjunction with the Revenue Commissioners, issue guidelines for charities in relation to trading activities. [Paragraph 3.27]

4.14 The Commission recommends that any charity which carries on trading activities which satisfy the legislative requirements for tax exemption should be allowed to avail of the proposed CIO structure. [Paragraph 3.31]

**APPENDIX A DRAFT CHARITIES (CHARITABLE
INCORPORATED ORGANISATIONS) BILL¹**

**CHARITIES (CHARITABLE INCORPORATED ORGANISATIONS)
BILL 2006**

ARRANGEMENT OF SECTIONS

1. Short title and commencement
2. Interpretation
3. Incorporation, constitution and trustees of CIO
4. Constitution of CIO
5. Objects and powers of CIO
6. Third parties
7. Conversion of existing charities
8. Regulations

ACT REFERRED TO

Charities Regulation Act 2006²

¹ For the purposes of this Report, the Commission has prepared a separate draft CIO Bill, but notes that it has recommended in paragraphs 2.11 and 2.72 that the introduction of the CIO should be incorporated into the proposed statutory regulation of charities, subject to any necessary transitional arrangements.

² This refers to the *Draft Scheme of the Charities Regulation Bill 2006*, published in 2006 by the Department of Community, Rural and Gaeltacht Affairs.

**DRAFT CHARITIES (CHARITABLE INCORPORATED
ORGANISATIONS) BILL 2006**

BILL

entitled

AN ACT TO PROVIDE FOR THE CREATION OF A CORPORATE BODY TO BE KNOWN AS THE CHARITABLE INCORPORATED ORGANISATION, TO PROVIDE FOR THE CONSTITUTION, OBJECTS AND POWERS OF THE CHARITABLE INCORPORATED ORGANISATION AND TO PROVIDE FOR RELATED MATTERS

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

Short title and commencement

1.- (1) This Act may be cited as the Charities (Charitable Incorporated Organisations) Act 2006.

(2) This Act shall come into force on such day or days as the Minister shall by Order provide.

Explanatory Note. Subsection (2) implements the recommendation in paragraph 2.72.

Interpretation

2.- (1) In this Act, unless the context otherwise requires –
“Act of 2006” means the Charities Regulation Act 2006;³
“a CIO” means the Charitable Incorporated Organisation referred to in section 3;
“the Minister” means the Minister for Community, Rural and Gaeltacht Affairs.

(2) A word or term to which a meaning is assigned by the Act of 2006 has the same meaning in this Act.

Explanatory Note. The reference in this section to the Charities Regulation Act 2006 (the Draft Scheme of the Charities Regulation Bill 2006) implements the recommendation in paragraph 2.11.

³ This refers to the *Draft Scheme of the Charities Regulation Bill 2006*, published in 2006 by the Department of Community, Rural and Gaeltacht Affairs.

Incorporation, constitution and trustees of CIO

3.- (1) A charity may be incorporated pursuant to the Act of 2006 as a Charitable Incorporated Organisation (in this Act referred to as “a CIO”) and entered on the Charities Register.

(2) A CIO shall be a body corporate having –
(a) a constitution, and
(b) at least 3 charity trustees.

(3) Without prejudice to the general duty of care of a charity trustee in the Act of 2006, the charity trustees of a CIO are not liable to contribute to the assets of the CIO if it is wound up.

Explanatory Note. Subsection (1) implements recommendations in paragraphs 2.69 and 2.91. Subsections (2) and (3) implement recommendations in paragraph 2.91.

Constitution of CIO

4.- (1) The constitution of a CIO shall –
(a) state its name and objects,
(b) specify, subject to *subsection (2)*, the conditions for use of the title CIO,
(c) specify eligibility to be a charity trustee on the same terms as in the Act of 2006,
(d) specify how a person may be appointed a charity trustee,
(e) specify the powers of the CIO, and
(f) specify that its powers may only be used to further its objects.

(2) The title ‘Charitable Incorporated Organisation’ or the letters ‘CIO’ shall appear in legible characters on all documents signed and issued by or on behalf of a CIO, and a CIO shall at all times ensure that it is represented as being, in fact, a CIO.

(3) The constitution of a CIO shall comply with such requirements as are specified in regulations made by the Minister.

Explanatory Note. This section implements recommendations in paragraph 2.91.

Objects and powers of CIO

5.- (1) A CIO shall use and apply its property in furtherance of its objects and in accordance with its constitution.

(2) Subject to its constitution, a CIO may do anything which is calculated to further its objects or is conducive or incidental to doing so.

(3) For the purposes of managing the affairs of a CIO, the charity trustees may exercise all of the powers of a CIO.

Explanatory Note. This section implements recommendations in paragraph 2.91.

Third parties

6.- (1) Any person who enters into a contract with a CIO in good faith and for value (in this section referred to as “the third party”) shall not be required to inquire whether –

(a) anything in the constitution of the CIO prevents it from entering into the contract with the third party, or

(b) anything in the constitution of the CIO (including limitations arising from a resolution at a general meeting of the CIO or arising from an agreement between its charity trustees) prevents the charity trustees of the CIO from entering into the contract with the third party.

(2) Nothing in *subsection (1)* shall prevent the third party from maintaining an action against the CIO, provided the action is not brought in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the CIO.

(3) Without prejudice to the general duty of care of a charity trustee in the Act of 2006, nothing in *subsection (1)(b)* shall affect any liability incurred by the charity trustees of the CIO (or any of them) for doing anything which the trustees (or trustee) do not (or does not) have the power to do.

Explanatory Note. This section implements recommendations in paragraph 2.91.

Conversion of existing charities

7.- (1) Any existing charity incorporated as a company limited by guarantee may convert to the CIO structure provided for in this Act and, where it does –

- (a) it shall comply with such requirements and conditions as may be prescribed in regulations made by the Minister, and
- (b) the Charities Regulator may in the exercise of his or her discretion, deem a company member or a company director (or either of them) to be and to become a charity trustee of the CIO upon completion of the conversion.

(2) Any existing charitable trust, unincorporated association or industrial and provident society may convert to the CIO structure provided for in this Act and, where it does, it shall comply with such requirements and conditions as may be prescribed in regulations made by the Minister.

Explanatory Note. Subsection (1) implements recommendations in paragraph 2.91. Subsection (2) implements recommendations in paragraph 2.95.

Regulations

8.- The Minister may by regulations provide for all or any of the following matters –

- (a) the name of a CIO,
- (b) the form which the constitution of a CIO shall take and the extent (if any) of any deviation permitted from such form and the circumstances (if any) in which such deviation is permitted,
- (c) the amendment of the constitution of a CIO,
- (d) the annual submission, for approval by the Charities Regulator, of the accounts of a CIO,
- (e) the conversion of existing charities, whether unincorporated or incorporated, to the CIO structure in a simple and cost-effective manner consistent with the purposes of the Act of 2006 and this Act;
- (f) the amalgamation of existing charities or CIOs,
- (g) the transfer of property, rights and liabilities from a CIO or existing charity to a similar body,
- (h) the winding up, insolvency or dissolution of a charity or CIO, including directions regarding the application of the property of a CIO in the event of the CIO being wound up,

Explanatory Note. This section implements recommendations in paragraph 2.92.