

National Council for Voluntary Organisations  
giving voice and support to civil society



# Managing risk

A New Approach for the Fit and  
Proper Regulation of Charities

In association with

**Deloitte.**

## **Introduction**

### **NCVO Task & Finish Group**

This report sets out the findings and recommendations of the Task & Finish Group set up by the National Council for Voluntary Organisations (NCVO) with the purpose of exploring the amount of financial crime, including fraud, affecting the charitable sector, and analysing the level of protection provided respectively by the Charity Commission and HMRC. In particular, the group was required to identify possible areas of overlap between these two bodies, and focus on whether the measures taken by HMRC are proportionate, transparent and effective when applied to the charity sector.

Throughout the course of its work, the group's overarching concern has been to ensure that charitable organisations, and the people who work within them, have the appropriate level of regulation. One that maintains public trust and confidence in our organisations, while at the same time enabling them to operate effectively and play their full role in civil society.

The Task & Finish Group first met on 24 November 2010 to discuss its terms of reference and ways forward. It was agreed that the group would examine the regulatory framework in which charities operate and the various measures aimed at preventing the occurrence of fraud. On the basis of the evidence gathered, recommendations would be provided to minimise red tape and reduce the regulatory burden on charities.

The group conducted its work through meetings with HMRC senior officials and Charity Commission senior staff, in order to properly inform its position and guarantee an impartial approach.

The group has produced this report in view of publishing and sharing its findings with key stakeholders, to ensure there is an informed debate about fraud in the charitable sector and how it is addressed by HMRC, the Charity Commission and the sector itself. The analysis of the regulatory framework in which charities operate should also ensure that any future proposals by Government are evidence based and targeted on specific risks and vulnerabilities.

The Task & Finish Group was set up at an opportune time, as one of the Government's key policy aims is to make it easier for sector organisations to be set up and managed. The Group has operated in parallel to the Government De-Regulation Taskforce run jointly by the Office for Civil Society and the Department for Business, Innovation and Skills.

The full Terms of Reference of the group can be found in Annex I.

Annex II lists the names and biographies of the Task & Finish Group members.

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## **Foreword by the sponsor, Deloitte LLP**

The charity sector has been the subject of much publicity and legislation in the past few years. Not only have we witnessed the introduction of a new Charities Act, there have also been many tax related developments. The publicity and the inevitable scrutiny that followed these developments are to be expected for a sector that benefits, in the main, from the goodwill of the public. With the economy at a standstill and the public purse suffering as a result, it is vital that the charity sector continues to benefit from public confidence.

None of us would be happy to see our donations being wasted, by mismanagement or fraud. However, whilst it is important that the scrutiny of the sector is carried out with due diligence, it should be done so in a way that is not detrimental to the sector. It should not discourage the public from 'taking part', nor should it impose unnecessary administrative burden on charities.

In what follows, the NCVO Task and Finish Group present a comprehensive study of the interaction between the Charity Commission and HMRC in regulation of fraud in charities. Importantly, the study has some valuable conclusions, the adoption of which could be beneficial to all connected to the sector.

**Reza Motazed**  
**Head of Charities and Not For Profit**  
**Deloitte**

## **Foreword by the Chair, Lord Plant of Highfield**

Charities are an enormously important part of British society. They make a real difference to the causes they work for, and therefore play a key role in improving individuals' lives and creating cohesive communities. However, many are currently facing a number of challenges, first and foremost the one of dealing with significant economic uncertainty.

In this climate, the constant threat of fraud becomes especially serious. It is therefore understandable that now, maybe more than ever before, one of government's priorities is to ensure that no revenue is lost and that institutions in society are not open to abuse by fraudsters.

Charities also need to take the appropriate measures to maintain their financial stability and ensure they are protected, so they are able to continue to play their fullest role in society. At the same time, there is a concern to maintain the robust reputation that is critical to ensure continued high levels of public support, so people can trust the charities to which they are donating money. While the incidence and cost of financial crime among charities remains low compared to other sectors, those that fall victim of this type of crime must deal not only with the direct financial losses, but also with adverse publicity, cancelled projects and the serious damage to the charity brand. In particular, we must take account of the vulnerability of charities to negative treatment from the media because of a few headline cases.

Any approach to the sector must be based on a clear understanding of the conditions in which charities operate, and should be sensitive to the importance of protecting the reputation of the sector. A key aspect of this is to ensure that any future proposal is formulated only after an informed debate and proper consultation with the sector. Better dialogue would certainly avoid repeating the confusion and inconsistencies of the kind that were caused by the hasty introduction of the 'fit and proper person' rules in the Finance Act 2010.

This is a useful and, indeed, timely report. It is published as government policy is moving towards a more efficient model of regulation and a greater emphasis on reducing burdens and unnecessary costs. HMRC has already announced that it is determined to take steps to improve its interaction with charities. This is a welcome announcement, which can be seen as further recognition of the mutual advantage gained from engaging relevant stakeholders and listening to their issues and concerns.

The Task & Finish Group is very grateful to all those who have contributed to its work and deliberations. In particular, it would like to thank HMRC and the Charity Commission, both of which have shown an encouraging level of openness and availability throughout the past months. Now it is important to build upon this positive relationship so it can continue to improve.

NCVO would like to acknowledge the support of our sponsors, Deloitte LLP, without which the publication and launch of the report would not have been possible.

**Lord Plant of Highfield, House of Lords, Professor of Jurisprudence, The Law School, King's College, London**

## **Executive Summary**

Charities are a vibrant and vital part of civil society, and it is essential that they can play their fullest possible role. The importance of financial security and access to finance, as well as robust governance structures, should not be underestimated when considering what is necessary to ensure that civil society, and the organisations that are part of it, are able to flourish.

The decision to set up the Task & Finish Group was prompted by the introduction in the Finance Act 2010 of new measures aimed to reduce the vulnerabilities of charities to financial criminal abuse such as fraud. In particular, concerns were raised by the new 'fit and proper person' test, which forms a strand of HMRC's new definition of charity for tax purposes and is now a condition for charitable reliefs.

There is a perception that the charitable sector's altruistic nature makes it a 'soft target' for fraudsters. In reality most of what is known comes from anecdotal evidence and a few headline cases in the media. Over the past couple of years a number of surveys have tried to fill this knowledge gap by investigating charities' attitude to fraud, measuring the incidence, size and nature of the frauds committed, and exploring whether charities of different types and sizes also experience fraud and its consequences in different ways.

Although occasional media accounts of high-profile scams that capture the public interest would lead many to believe otherwise, the estimates based on the data collected indicate that fraud in the charity sector is much lower than for other sectors of the economy. Nevertheless, there are real concerns about the potential abuse of charities for financial criminal purposes. This is particularly the case with regards to Gift Aid claims made by small organisations that are not registered with the Charity Commission and therefore do not fall within its regulatory remit.

Therefore, the threat of tax fraud involving charities is one to be taken seriously and it is certainly the duty of Government to ensure institutions in society, whether they are in the public sector, the private sector or the voluntary and community sector, are not open to abuse. However, any approach motivated by a legitimate concern with fraud should be sensitive and not undermine the general confidence in the sector on the part of donors, funders, beneficiaries and the general public. In particular, when assessing the extent to which charities may be at risk of fraud and the need to introduce specific anti-fraud measures, it is important to consider first of all the role of the Charity Commission as the primary regulator of the charity sector.

Most importantly, Government needs to work in partnership with the sector to ensure the risk of charities being involved in fraud is addressed in the most effective way. The changes brought by the Finance Act last year caused alarm and confusion mainly because they were introduced without any meaningful consultation, and without apparent consideration of the environment in which charities operate. While recent changes to HMRC's guidance on the application of the 'fit and proper person' test have led to improvements, many of the problems encountered could have been avoided from the start by engaging the sector and ensuring proper dialogue with key stakeholders.

## **Recommendations**

To help improve the regulatory framework in which charities currently operate, the Task & Finish Group makes the following recommendations that should enable both the Charity Commission and HMRC to carry out effectively their respective roles in fraud prevention, and therefore maintain public trust and confidence in the charity 'brand', while at the same time minimising the administrative burden on charities.

### ***1. The charity and community sector should be involved and consulted effectively***

The Task & Finish Group welcomes HMRC's willingness to engage in talks with the sector and amend its guidance in accordance with the concerns expressed. Encouraged by this goodwill, the Group would like to highlight the importance of ensuring that in future there is proper and meaningful dialogue between the sector and Government, in compliance with the principles set out by the Compact. It is essential that all Government departments involve and consult the charity and community sector effectively, from the earliest stages of policy development and legislative change. By ensuring proper engagement, Government will be able to make informed decisions that result in better outcomes for all stakeholders.

### ***2. Any legislative and regulatory measure must be proportionate and evidence based***

Existing legal and regulatory requirements on charities must be properly considered before new duties are imposed. Any new measure must be proportionate and evidence based, building upon the existing system of charity law and regulation.

### ***3. The importance of the Charity Commission's role as an independent civil regulator must be recognised***

Government should be considerate of the valuable oversight already provided by independent civil regulators such as the Charity Commission. The fact that the Charity Commission operates independently of both government and the charitable sector is essential to safeguard public trust and confidence in the sector, and the integrity of the charity 'brand'. An independent regulator acts in the public interest, meaning it is sheltered from prevailing political pressures on the one side (and therefore has the confidence of charities, donors, beneficiaries and the wider public), and does not get too closely identified with charities on the other. In this position, the Commission is uniquely placed to undertake an objective assessment of the potential risks to the sector and to individual charities where there is evidence of mismanagement, fraud or abuse.

**4. *The Charity Commission and HMRC should look at ways of improving their information sharing, such as establishing information 'gateways'***

The Charity Commission and HMRC should work together to improve access to information and create 'gateways' where duplication has been identified. Gateways provide a single point of access to a specific set of information, and by allowing them the Charity Commission and HMRC would make a considerable contribution towards the simplification and automation of dialogue. In the longer term, it would be desirable that the Charity Commission, HMRC and other relevant bodies (such as Companies House for example) explore ways of setting up a joint online system which would act as a 'one stop' for charities. This single database would help towards easing the current burdens on charities caused by repeated requests for the same type of information, while at the same time allowing efficiency and cost savings to governmental and non-governmental departments.

**5. *The new 'fit and proper person' test must be applied in an objective and reasonable way***

HMRC's guidance should be amended so that a decision on whether an individual meets the 'fit and proper person' test is based on a standard that ensures the test is applied in a manner that is objective and reasonable. Measures should also be put in place in order to ensure HMRC is properly accountable for the judgements it makes.

**6. *The Gift Aid system should enable charities to file claims entirely online***

The Task & Finish Group welcomes HMRC's launch of a new Gift Aid toolkit whereby forms can be downloaded from the website. However, HMRC should take further steps to update its software so that applications for Gift Aid approval can also be completed and submitted online. This would enable charities to complete and return forms without the need to download documents and send them through the post.

**7. *All charity tax guidance should have version control software to enable any changes to be tracked***

HMRC should take the necessary steps to set up version control of its guidance on the 'fit and proper person' test and other charity tax guidance. Version control software allows the management of changes to documents, by identifying the change and associating each revision with a timestamp and the person making the change. This would provide reassurance to those relying on the guidance that they have a legitimate expectation to not be pursued even if the guidance is subsequently changed.

**8. *The law relating to the disqualification of trustees should be included in the review of the Charities Act 2006***

The law relating to the disqualification of charity trustees should be subject to the review of the Charities Act in Autumn 2011. In particular, consideration should be given as to whether the power of the Charity Commission under s18 of the 1993 Act to suspend or remove a



trustee requires any extension to provide an option of temporarily suspending individuals who are subject to an investigation by HMRC into whether they are 'fit and proper' to be a charity manager.

**9. *The provisions on disclosure of information between the Charity Commission and HMRC should be included in the review of the Charities Act 2006***

Cooperation between the Charity Commission and HMRC should be improved in order to enable both bodies to better discharge their functions. In particular, the provisions on disclosure of information in s10 of the 1993 Act should be included in the review of the Charities Act 2006. HMRC should be allowed the option of disclosing information to the Charity Commission not only if it relates to a charity, but also personal taxation issues when the individual concerned is a member of the charity's governance board.

**10. *HMRC and the Charity Commission should engage the sector to develop and promote good practice and self-regulation***

HMRC and the Charity Commission should work with the sector to develop and disseminate good practice and promote sector led initiatives that enable charities to develop effective responses to fraudulent activity. Where appropriate, there should be an emphasis on self regulation and on existing measures taken by individual charities to mitigate the specific risks faced by their organisation.

**11. *Relevant sector bodies should take steps to increase awareness of existing financial control measures***

Building on their expertise and previous work, relevant sector bodies should continue to increase public awareness and understanding of existing regulation and of the financial control measures already developed within the sector, in order to spread good practice and ensure public trust and confidence in the sector is maintained. The Task & Finish Group in particular welcomes the recent announcement by the National Fraud Authority that, in refreshing the National Fraud Strategy, it will seek the engagement of representatives from the charity sector in order to secure a greater understanding of the commitments and plans the sector already has in place.

**12. *Relevant sector bodies should consult with charities to develop appropriate models of counter-fraud and financial control mechanisms***

Charity practice in relation to preventing fraud should be strengthened. Relevant sector bodies should consult and work in collaboration with charities of different size and income to develop models of counter-fraud mechanisms, and broader financial controls.

**13. *The importance of anti-fraud mechanisms within good governance should be emphasised***

To further strengthen the role of anti-fraud mechanisms as part of good governance, the revised Code of Good Governance for the voluntary and

community sector should include a reference to the responsibilities of trustees in setting up mechanisms to prevent and detect fraud.

## The Finance Act 2010 and the 'fit and proper person' rules

The decision to set up the Task & Finish group was prompted by the introduction in the Finance Act 2010 of new measures aimed to reduce the vulnerabilities of charities to financial criminal abuse such as fraud. In particular the new 'fit and proper person' test, which forms a strand of HMRC's new definition of charity for tax purposes.

In order to qualify for a number of tax exemptions and reliefs, it has always been the case that charities need to be formally recognised by HMRC. Prior to the Finance Act 2010, the status of an English or Welsh charity registered with the Charity Commission was not subject to scrutiny by HMRC and there was no formal process. In order to qualify for charitable reliefs it was considered sufficient to provide HMRC with evidence of being registered with the Charity Commission in the form of supplying a registered charity number. This was subject to the possible application of specific anti-avoidance rules on qualifying operations or the qualifying donor rule.

The Finance Act 2010 introduced a new definition of '*charity*' for tax purposes. According to Schedule 6 of the Act, a 'charity' means a body of persons or trusts that:

- a) is established for **charitable purposes** only;
- b) meets the **jurisdiction condition**;
- c) meets the **registration condition**; and
- d) meets the **management condition**.

While the first three conditions are already covered by charity law and do not alter the previous position<sup>1</sup>, as far as UK charities are concerned, the 'management condition' is a novel element in the new tax definition of charity. This is the measure that has been introduced to mitigate the risk of financial abuse and fraud. Meeting the condition requires that the 'managers' of the organisation are 'fit and proper persons' to act in that capacity. If the 'fit and proper person' test is not met, the result is in principle the withdrawal of all of the charitable tax reliefs and exemptions relating to the organisation under scrutiny.

### Why was the new charity definition introduced?

The new definition was proposed by HMRC to provide safeguards against the abuse of the UK's charitable tax reliefs, due to the extension of those reliefs to charities in the European Union, Norway and Iceland.<sup>2</sup>

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<sup>1</sup> Under the statutory definition in the Charities Act 2006, a charity established in England and Wales must have charitable objects only. The jurisdiction condition means that the organisation must be subject to the jurisdiction of the UK courts or of the courts in the state where it is established. The registration condition means that in practice the organisation must be registered with its local regulator.

<sup>2</sup> This expansion was required of the UK Government under EU law following the case of *Hein Persche v Finanzamt Lüdenscheid (C-318/07)*, which found the restriction of charitable tax reliefs to organisations established in one particular member state was prohibited under the EC Treaty.

Although this extension is based on a body of European jurisprudence<sup>3</sup> that might reasonably require consideration of whether new safeguards are necessary to protect against an increased risk of fraud, there could be far reaching unintended consequences for charities in England and Wales. The potential for uncertainty and added administrative burden arising from a dual assessment of charitable status is substantial. This is particularly so in a jurisdiction with a sophisticated regulatory system for charities, such as the UK.

Furthermore, there is little evidence that any regulatory authorities beyond HMRC or the sector itself were properly consulted on the changes announced in last year's Budget. Prior to the Budget HMRC convened a confidential meeting to which it invited a small number of representatives from the charity sector, in the hope that these discussions would help shape the final form of the Government's proposals. However, the meeting took place without the benefit of any draft guidance or legislation and, due to the condition of confidentiality, those present were unable to canvass the views of their stakeholders. These conditions, combined with the pre-budget embargo and the speed at which the Finance Act needed to be brought into force, meant that the resulting legislation became law without any meaningful sector consultation.

As a result of the Commission's activity, a number of other EU Member States have adopted legislation that effectively resolves the issue of 'land locking', that is the direct or indirect geographical limitation imposed as a condition for recognising or allowing favourable tax treatment of philanthropic activities, and therefore discriminates against foundations established in other Member States in comparison to domestic organisations. Tax law reforms have recently been implemented in Poland, Slovenia, the Netherlands, Denmark, the Czech Republic, Luxembourg, Bulgaria, Latvia, Greece, Belgium, Germany and France.<sup>4</sup>

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<sup>3</sup> *Persche* is the latest development in a body of case law emerging from Europe that suggested the UK's position on cross-border giving would have to change. The leading cases (*Ditmar*, *Stauffer* and *Persche*) have considered whether domestic restrictions on the availability of charitable tax reliefs are compatible with the EC Treaty. In all these cases the European courts found in that restricting cross-border charitable activity (either by confining charitable tax relief only to organisations established in the Member State, or by not permitting tax relief on a donation made to a charity in another member state) offended the principles of the EC Treaty.

<sup>4</sup> The tax discrimination encountered by philanthropic organisations and donors working across borders within the EU is examined by Dr. Ineke Koele in '*How will international philanthropy be freed from landlocked tax barriers?*' available at <http://www.efc.be/Legal/Documents/European%20Taxation%209%202010%20International%20Philanthropy%20Freed%20from%20International%20Tax%20Barriers.pdf>. The article also examines how tax barriers to philanthropic work might most responsibly be eliminated to both enhance and protect the sector.

## Evidence of fraud in the charity sector

The need to introduce new measures to counter fraud in the charitable sector should be considered in light of the level of fraud actually occurring within charitable organisations.

There is a perception that the charitable sector's altruistic nature makes it a 'soft target' for fraudsters compared to organisations operating in other sectors. In a recent survey about fraud in the charitable sector<sup>5</sup> half of respondents agreed with the assertion that fraud is a major risk to charities, and a quarter agreed that fraud is a greater risk to the charity sector than to other sectors. The main reason given for this perceived vulnerability was the sector's reliance on goodwill and trust which, it is thought, can allow fraudsters to take advantage of the organisation. However in reality most of this perception is based on anecdotal evidence and a few headline cases in the media. When it comes to measuring the incidence of fraud among charities, even informed estimates vary widely.

Over the past couple of years a number of surveys have tried to fill this knowledge gap by investigating charities' attitudes to fraud, measuring the incidence, size and nature of the frauds committed, and exploring whether charities of different types and sizes experience fraud and its consequences in different ways. The most important finding is that, while fraud is a big cost to the country's economy, its overall incidence among charities appears to be much lower than elsewhere, and when fraud does occur it tends to involve much smaller sums.

Indeed, the most recent assessment of fraud loss in the charitable sector, which is provided by the National Fraud Authority's 'Annual Fraud Indicator'<sup>6</sup>, estimates that total lost turnover for the sector is around £1.3 billion a year. While this at first impression may seem like a high amount, it represents only an average of 2.4% of charities annual turnover. It should also be considered in light of the AFI's key findings regarding the rest of society, for example: fraud against the public sector accounts for 55% of all fraud loss, with estimated losses of £21.2 billion; and private sector fraud is estimated to cost the UK economy £12 billion a year, accounting for 31% of total fraud loss.

The estimated £1.3 billion figure captures fraud against charities (for example fraud perpetrated by employees and/or volunteers, or fraudulent applications for grants and/or financial support) as well as some of the financial impact that fake or sham charities have on legitimate charities. However, it does not include loss resulting from organisations that are promoted as if they are charitable, but are in fact not registered as a charity and have no intention of using donations for charitable purposes.

In order to produce this estimate of fraud in the charitable sector, the NFA carried out targeted measurement work asking charities to share their experiences of fraud

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<sup>5</sup> Fraud Advisory Panel (February 2009) *Fraud in the charitable sector*. Available at [http://www.fraudadvisorypanel.org/newsite/pdf\\_show.php?id=103](http://www.fraudadvisorypanel.org/newsite/pdf_show.php?id=103).

<sup>6</sup> *Annual Fraud Indicator* (January 2011). Available at <http://www.attorneygeneral.gov.uk/nfa/WhatAreWeSaying/Documents/AFI%202011.pdf>

and to provide an estimate of what percentage of their income may have been lost to fraud. The survey revealed that 11% of charities have been the victim of fraud at least once within the last five years. Of those identifying themselves to be a victim of fraud, 47% had been the victim of fraud perpetrated by an employee or volunteer. It should be noted that such an occurrence would not be caught by the new 'fit and proper person' rules, and therefore the majority of fraud against charities remains to be prevented.

### **Types of fraud in the charity sector**

Many of the risks to charities are similar to, or the same as, those affecting other sectors of the economy (such as e-crime, plastic card fraud, data theft, money laundering, terrorist financing and employee fraud). But there are also risks that are more specific to charitable organisations. These are mainly risks related to fundraising activities and grant giving, and the abuse of charitable status to avoid paying tax.

Tax authorities have detected several methods and schemes involving the abuse of charities to facilitate tax evasion, crime and money laundering<sup>7</sup>. However, fraud is thought to centre mainly on Gift Aid within charities that are not registered with the Charity Commission, or within new organisations that appear to be charities but in reality are vehicles set up to exploit the Gift Aid system. Although the amounts involved are relatively low, Gift Aid is the most widely used scheme to obtain charitable tax reliefs<sup>8</sup> and the high volume of attempted claims makes this a real issue for HMRC. Ruses include:

- A genuine charity that makes legitimate Gift Aid claims is abused unknowingly by a third party. This can happen for example through the charity's identity being taken over, so fraudsters divert Gift Aid payments to a new bank account. Or another recurring instance is when the fraudsters steal the details of genuine people working within the charity and use their names on application forms, to try to get access to Gift Aid and get what the charity should receive paid into their bank accounts.
- An organisation poses as a charity to perpetrate a tax fraud through fictitious Gift Aid claims on donations that never existed.

The 'fit and proper person' rules are therefore intended to focus on preventing the abuse of charities for fraudulent purposes that occurs in both these instances: when the charitable status of an organisation (and therefore its entitlements to tax relief or tax benefits) is wilfully misused either by someone within the charitable organisation itself, or by third parties such as fraudsters who pose as a charitable organisation.

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<sup>7</sup> Organisation for Economic Cooperation and Development *Report on Abuse of Charities for Money-Laundering and Tax Evasion* (February 2009). Available at <http://www.oecd.org/dataoecd/30/20/42232037.pdf>.

<sup>8</sup> According to the *UK Civil Society Almanac 2010* (NCVO), by 2007/08 up to 67,000 organisations reclaimed Gift Aid, amounting to one third (34%) of UK voluntary organisations. The amounts are also on the increase, as shown by the fact that in 2008/09 the value of Gift Aid claims reached £947 million.

## **The regulatory framework in which charities operate**

When assessing the extent to which charities may be at risk of financial crimes such as fraud and the need to introduce specific anti-fraud measures, it is important to identify the relevant legal and regulatory requirements that already govern the sector and ensure that risks are mitigated to a certain extent.

However, it is also important to consider the competing statutory duties that the Charity Commission and HMRC have to meet. Both the Charity Commission's and HMRC's approach to charities and fraud need to be examined in light of their mission statements, which are underpinned by different values and focus on distinct priorities. This clearly has a high level of influence of each body's general role and the way they specifically deal with instances of fraud in the charitable sector.

The Charity Commission's aim is to give the public confidence in the integrity of charity. The Commission's key objectives are to:

- ensure that charities are able to operate with an effective legal, accounting and governance framework;
- improve the governance, accountability and effectiveness of charities; and
- identify and deal with abuse and poor practice.

Among its specific statutory functions, the Commission has a general responsibility to promote the effective use of charitable resources by encouraging better administration, providing information and advice to trustees and investigating abuses.

As a civil regulator, the Charity Commission's main concerns are maladministration and financial mismanagement. Fraud is a criminal offence and the Commission does not act upon it for the purposes of prosecution, but rather reports its occurrence to the police and other enforcement authorities (including HMRC).

However, financial crimes such as fraud, theft and money laundering can result not only in significant loss of charitable funds but also in damage to the public trust and confidence in charities more generally. Therefore, in accordance with its statutory objective to increase public trust and confidence in charities, when identifying and investigating apparent misconduct or mismanagement in the administration of charities, the Commission also aims to help the organisation resolve the issues encountered. It does so mainly by providing advice and support to the board of trustees so they can ensure the good governance of the charity, and only where necessary will it make use of its legal powers to protect the charity.

On the other hand, the main purpose of HMRC is to administer the tax system so that taxes are properly enforced and collected. HMRC's main concern is revenue protection and the avoidance of abuse, to ensure that money is available to HM Treasury to fund public expenditure. HMRC's aim is to secure the highest level of compliance with the law and regulations governing taxes and other regimes for which they are responsible. Therefore criminal investigation with a view to prosecution is an important part of HMRC's overall enforcement strategy. Moreover,

when dealing with charities, HMRC has no concurring concern about approaching organisations in a manner that ensures the general reputation of charities is protected.

### **Oversight provided by the Charity Commission**

The regulatory framework in which charities operate is governed mainly by the Charities Acts 1993 and 2006. Both Acts have introduced measures aimed at making charities more accountable and provided for the Charity Commission to play an increasingly active supervisory role, in particular, setting a clear framework for monitoring charities.

A charity is an institution established for the public benefit and with purposes recognised as charitable in law. Most charities with an annual income over £5,000 are required to register with the Charity Commission, unless they fall in the category of exempt and excepted charities.<sup>9</sup>

Registration with the Charity Commission has a range of implications:

- Normative – the status of being a registered charity is highly valued, and it is seen as a badge of credibility that enhances public trust and benefits relations with potential donors.
- Legal – Registered charities are required to file annual reports and returns with the Commission and to include certain information in those documents (the framework for accounting and reporting sets out different requirements depending on the legal form of the charity, and the levels of gross income and assets).
- Fiscal – Registration brings a range of tax benefits not available to commercial organisations. Charities have certain reliefs from income and corporation tax and business rates, and can usually claim back the basic rate tax paid on donors' incomes where gifts are made by deed of covenant or under the Government's Gift Aid schemes.

The Commission's regulatory jurisdiction, however, extends beyond charities which are required by law to be registered, covering all funds that are raised by any organisation within England and Wales for charitable purposes.

Overall, the Charity Commission's regulatory requirements are not perceived as particularly burdensome or disproportionate by the majority of charities. In fact, charitable status is highly valued and particularly the 'badge' of registration: it acts as a mark of official recognition with funders and the general public, helping the charity access funding and giving it stronger credibility in its dealings.

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<sup>9</sup> According to the most recent figures published on the Charity Commission's website, there are approximately 190,000 registered charities in England and Wales. Of these, around 75,000 have an income below £10,000 and around 45,000 have an income below £5,000. Data indicates that across the territory there are another 100,000 organisations set up for charitable purposes but not registered.



## **Why are charities regulated?**

Charities receive public support in many ways through donations, the time and effort of volunteers, funding from government and charitable donations, and through the tax system. Each charity has a governing document which sets out, amongst other things, the charitable objects that it exists to pursue. Donors, beneficiaries and the wider public are entitled to the assurance that charities actually pursue these objects, that they don't spend charitable funds in ways that the objects do not authorise, and that they operate for public rather than private benefit.

While responsibility for ensuring that charities are well run resides primarily with trustees, over the years the sector has become exposed to a wider range of risks, making it more difficult for voluntary trustees to exercise full control. The Charity Commission exists to minimise these risks, and one of its core functions is to promote compliance by charity trustees with their legal obligations in exercising control and management of the administration of their charities; and promote the effective use of charitable resources.

## **Role of the Charity Commission in the event of fraud**

In order to properly understand the allocation of responsibilities between the Commission and HMRC in this area, it is important to consider first of all the role of the Charity Commission as the primary regulator of the charity sector.

When fraud occurs in charities, the Charity Commission has an important role in considering whether the criminal activity indicates that there has been mismanagement of the charity and whether it needs to act to protect charitable funds. The Commission is also responsible for ensuring that trustees deal with any incidence of fraud responsibly and take appropriate steps to ensure that the charity is better protected against any future risk of fraud.

The Charity Commission has a wide range of statutory powers that enable it to protect charity funds by investigating and intervening in the way that charities are run. The Charity Commission approaches fraud on the basis of a four strand strategy:

- monitoring;
- investigation;
- prevention;
- partnership working with other agencies and departments.

## **Monitoring**

### ***Eligibility checks on individuals***

Some people are disqualified by law from acting as trustees<sup>10</sup>, and one way in which the Charity Commission aims to maintain public confidence in charities is by checking

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<sup>10</sup> Section 72(1) of the Charities Act 1993. This includes:

- anyone who has an unspent conviction for an offence involving deception or dishonesty;
- anyone who is an undischarged bankrupt;
- anyone who has been removed from trusteeship of a charity by the Court of the Commissioners for misconduct or mismanagements; and

that these individuals do not carry out any role in charities. It does so firstly by monitoring whether charities are checking the eligibility of their trustees, in a number of ways:

- when an organisation applies to register as a charity, prospective trustees are asked to complete a declaration confirming that they are not disqualified from acting as a charity trustee;
- the Commission carries out appropriate checks when exercising its legal powers to appoint trustees under s18 of the 1993 Act.

The Charity Commission also maintains a Register of Removed Trustees. This is a list of individuals who have been removed from the office of charity trustee by an order made by the Commission itself or the High Court, on grounds of misconduct or mismanagement in the administration of a charity, and who are consequently disqualified from acting as a trustee.

Lastly, the Charity Commission runs data checks against public lists held by other bodies, such as the Insolvency Service. Last year, this enabled the Commission to identify 940 individuals appearing on the Register of Charities as trustees despite being subject to Bankruptcy Orders or Individual Voluntary Arrangements which had not been discharged, or being disqualified as a company director. This process enables the Commission to ensure that the charities concerned take appropriate steps so the disqualified individuals no longer act as trustees.<sup>11</sup>

### ***Appointment and Removal of Trustees***

In addition to these pre-emptive eligibility checks, the Commission has a number of powers in relation to the removal and appointment of trustees.<sup>12</sup>

## **Investigation**

### ***Information Powers***

The Commission has the power under s9 of the 1993 Act to obtain information about charities and their activities. This includes the power to make an order requiring a person to provide it with information in his or her possession, or documents in his or her custody or control which relate to any charity and which are relevant to the functions of the Commission.

### ***Section 8 Inquiries***

If the Commission is alerted to any misconduct or mismanagement in relation to an individual charity, it has the power under s8 of the 1993 Act to institute an inquiry into the charity. The scope of the power is drafted in wide terms<sup>13</sup> and there are no

- 
- anyone under a disqualification order under the Company Directors Disqualification Act 1986.

<sup>11</sup> *Charities Back on Track – Themes and Lessons from the Charity Commission’s Compliance Work 2009-2010*. Available at <http://www.charity-commission.gov.uk/Library/track10.pdf>.

<sup>12</sup> Section 18 of the 1993 Act.

<sup>13</sup> The Commission may ‘from time to time institute inquiries with regard to charities or a particular charity or class of charities, either generally or for particular purposes’.

statutory pre-conditions imposed on the Commission's discretion to institute an inquiry.

Furthermore, once an inquiry has been opened, the Commission has a range of heavyweight powers to act for the protection of the charity.

## **Prevention**

In its role as 'friend' of charities, the Commission helps charity trustees by producing guidance on their legal responsibilities and what they can do to minimise the risk of fraud. The various publications range from basic guidance explaining the main duties with which trustees must comply in the administration of a charity (*'The Essential Trustee Guide'*<sup>14</sup>) to specific advice on strategies to ensure a charity's assets are protected and financial risk is managed to reduce losses to a minimum, including those occurring through theft and fraud (*'Charities and Risk Management'*<sup>15</sup>, *'Internal Financial Controls'*<sup>16</sup>, *'Compliance Toolkit – Protecting Charities from Harm'*<sup>17</sup>).

## **Partnership working with other agencies and departments**

By maintaining the Register of Charities, the Commission holds a wide range of information about charities and individuals. Beyond this, the Commission can gather information from other public bodies such as Government departments, law enforcement agencies and regulators through the gateway of section 10 of the Charities Act 1993<sup>18</sup>. In general terms, the Commission would receive information indicating harm to, or abuse of, a charity, its assets, beneficiaries or reputation.

However, the provisions of section 10 are specifically limited with regards to HMRC. HMRC can only disclose information to the Commission if it relates to a charity or similar institution. This does not include personal taxation information, which HMRC is very careful not to share. However, if the individual concerned is in a pivotal position on the charity's governance board there would be valid reasons for the Charity Commission to be aware of the situation.

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<sup>14</sup> CC3 – *The Essential Trustee: What you need to know* (February 2008). Available at <http://www.charity-commission.gov.uk/Publications/cc3.aspx>.

<sup>15</sup> CC26 – *Charities and Risk Management: A Guide for Trustees* (June 2010). Available at <http://www.charitycommission.gov.uk/Publications/cc26.aspx>.

<sup>16</sup> CC8 – *Internal Financial Controls for Charities* (June 2010). Available at <http://www.charitycommission.gov.uk/publications/cc8.aspx>.

<sup>17</sup> *Protecting charities from harm (the 'compliance toolkit')*. Available at [http://www.charity-commission.gov.uk/Our\\_regulatory\\_activity/Counter\\_terrorism\\_work/protecting\\_charities\\_landing.aspx](http://www.charity-commission.gov.uk/Our_regulatory_activity/Counter_terrorism_work/protecting_charities_landing.aspx).

<sup>18</sup> According to the Charities Act 1993, the Commission may share information with 'any relevant public authority' if it is for the purpose of enabling or assisting that party and/or the Commission to discharge any of its functions.

## **HMRC's approach to charity fraud**

HMRC is understandably concerned about the potential for fraud by individuals using charities and by rogue charities. Before the Finance Act 2010, HMRC worked on the basis of a 'look back' system where tax reliefs were provided in advance, on trust. If any malpractice occurred, for example the charity did not apply donations or other income or gains for charitable purposes, HMRC could only attempt to claw back the charitable reliefs. Where a charity made an innocent mistake HMRC could usually recover the tax due, but this became very difficult if fraudsters were operating from within.

In HMRC's view, the advantage of the new regime is that it enables to prevent the repayment of tax and to refuse charitable tax exemptions before they are given if HMRC suspects that there may be any risk of fraud, without the need to wait for impropriety to occur. The 'Fit and Proper Person' test therefore makes it harder for sham charities and fraudsters working within a charity, or targeting a charity from outside, to abuse charity tax reliefs, by ensuring that charities are not managed or controlled by individuals who present a risk to the charity's tax position.

### **Concerns over HMRC's guidance on the 'fit and proper person' test**

In the legislation, the provisions outlining the 'fit and proper person' test are vaguely drafted, containing no objective criteria for determining whether or not managers are fit and proper persons. This inevitably means that much of the substance and how the test applies in practice is left to be determined by HMRC's guidance on the subject. HMRC is able to adopt a subjective approach to consideration of the 'fit and proper person' test, given that the legislation does not provide any objective test of what constitutes a 'fit and proper person'.

HMRC's guidance on the 'fit and proper person' rules has been modified a number of times, and although the most recent version is much improved, there are still some issues that cause concern. These relate to the wide scope of the test, the amount of discretion exercised by HMRC, and the information it holds. The guidance also has wider implications regarding HMRC's approach to charities and existing charity law.

### **Scope of the test**

The Act defines "*managers*" as "*the persons having the general control and management of the administration of the body or trust.*" This matches exactly the definition of "*charity trustees*" in section 97 of the Charities Act 1993, suggesting that Parliament's intention was that only charity trustees would be required to demonstrate compliance with the "fit and proper person" test.

However, the guidance issued by HMRC to explain how they intend to interpret this definition in practice suggests that "*managers*" will extend far beyond a charity's trustees, applying to any official who has general control and management over the running of the charity and the application of its assets. This broad reference causes considerable uncertainty for charities, who are unable to know for sure which

individuals need to meet the fit and proper test and, consequently, whether or not they meet the definition of charity for tax purposes.

In response to concerns over the burden of administering such a broad definition, HMRC has reversed its starting position. According to the latest version of the guidance, HMRC accepts that, unless a charity is a sham, it would never knowingly appoint trustees or employ individuals in positions of trust if they are known to be dishonest. Therefore, it assumes the management condition is satisfied, provided charities take 'appropriate steps' on appointing personnel.

### **How HMRC applies the 'fit and proper person' test**

HMRC's approach is 'risk based', therefore it will not routinely ask charities to demonstrate that their managers are fit and proper persons. Full checks are carried out only where there appears to be a high risk of non-compliance, for example when it has received information of potential fraud.

HMRC is obviously attempting to reassure charities that they can generally assume they meet the management condition. However, this is subject to the charity's ability to demonstrate at any given point that consideration has been given as to whether their managers are fit and proper persons. It appears, therefore, that HMRC is expecting charities will implement its suggested self-certification procedure by asking all their newly appointed managers to sign the relevant declarations. However this is likely to considerably increase the administrative burden.

### **Information held by HMRC**

The guidance warns that individuals who are considered by a charity regulator as suitable to act as trustees of charities may not necessarily be considered 'fit and proper persons' for the purposes of the management condition. HMRC's justification is that charity regulators have different responsibilities and priorities from those of HMRC and therefore carry out different sorts of checks on individuals. Also, HMRC has access to confidential information that is not available to charity regulators (such as the Serious Organised Crime Agency database).

The guidance provides a list of factors that may lead to HMRC deciding that a manager is not a fit and proper person. These include not only whether the individual has been disqualified from acting as a trustee, but also a history of tax fraud or other fraudulent behaviour, and 'HMRC knowledge of involvement in attacks against or abuse of tax repayment systems'.

However, the list is non exhaustive and does not specify what level of proof is needed. This introduces another element of uncertainty for charities, which remain unclear about the criteria they are required to meet in order to satisfy the fit and proper person test. Particular concern is caused by the provision that an individual might be judged not 'fit and proper' where there is 'HMRC knowledge of involvement in abuse of tax repayment systems'. 'HMRC knowledge' could be information or accusations untested in court or by an independent body, and it is unclear whether individuals would have full access to the evidence used by HMRC to make its decision.

### **HMRC subjective discretion**

HMRC retains a wide degree of discretion in a number of other circumstances. For example, the guidance states that the 'fit and proper person' test is not intended to deny tax reliefs to charities that make a genuine mistake. HMRC has discretion to deem that the management condition has been met – even if one or more managers are not fit and proper – where it considers that a charity's purposes have not been prejudiced, or where it is 'just and reasonable' for HMRC to do so. While this flexibility is to be welcomed, it also raises the question whether the test is based on HMRC's subjective views. The absence of any clarification of what HMRC would consider being 'just and reasonable' introduces a considerable element of ambiguity.

The guidance also attempts to reassure charities that, although the definition of 'managers' covers a potentially wide range of individuals, charities need only tell HMRC when they appoint or change certain categories of managers (such as the 'authorised official' and the 'responsible persons'). However, it also provides that 'HMRC may ask a charity about any of its managers'. Once again, this permits considerable scope for arbitrary action by HMRC and could lead charities to err on the side of caution, even if it means over-reporting to HMRC, and therefore increasing their administrative work.

### **Individual's right of appeal**

The earlier version of the guidance did not provide for any direct right of appeal for the individual against HMRC's decision that they were not 'fit and proper'. So, if a person was dissatisfied with HMRC's decision, they could only go through the normal HMRC complaints procedure. This raised considerable concerns for the civil rights of charity managers, who could find themselves effectively excluded from working in the charity sector if HMRC were to find that they did not qualify as a 'fit and proper person' and with no route to appeal against such decision.

The revised guidance gives the individual concerned the opportunity to challenge HMRC's view by outlining a process with various stages of review. In the event that the person has exhausted HMRC's complaints procedure and is still dissatisfied with the final response received, they can ask the independent Adjudicator to look into the case.

This is obviously a step in the right direction and provides some reassurance, but it remains to be seen whether the process is sufficiently open and fair, especially considering that the initial review stages occur within the HMRC Charities department, and some managers are unlikely to have the time or knowledge of process to pursue a complaint all the way to the Adjudicator.

### **Change of Charity Law**

By providing a new definition of 'charity' for tax purposes, schedule 6 of the Finance Act 2010 enacts a radical change to charity legislation, with far reaching implications.

Furthermore, the new provisions link an organisation's charity tax status not only to the nature of the institution, but also to the character and record of the individuals

responsible for running that institution. The result in principle is that an individual's ability to pass the 'fit and proper person' test affects the entitlement to charitable tax reliefs of that organisation.

### **Use of guidance as a solution to vague or over-wide legislation**

The fact that the Finance Act 2010 is so poorly drafted has led to a 'guidance driven approach', whereby it is entirely left to HMRC's guidance to set out how the test is applied. The result is that HMRC's guidance is effectively 'quasi-legislation' and perceived as a statement of the law. At the same time HMRC retains considerable subjective discretion and views its guidance as a 'living document' to be revised periodically.

The use of guidance is not a satisfactory solution to a legislative problem. There are several reasons for this:

- firstly, guidance is not subject to the level of Parliamentary scrutiny and care in drafting that is given to legislation;
- secondly, the guidance and its application tends to depend a great deal on HMRC's own interpretation of the legislation;
- thirdly, individuals and organisations that rely on the guidance enjoy varying degrees of certainty depending on the type of transaction involved – while specific guidance can be relied upon when entering a single transaction, in relation to a continuing state of affairs there is exposure to changes in the guidance;
- lastly, the constant possibility of changes to the guidance is a potential source of uncertainty, and can result in unnecessary costs associated with monitoring the guidance and taking legal advice on its unclear aspects.

### **Administrative and Bureaucratic Burden**

The most immediate concern raised by the 'fit and proper person' test was that, in practice, the burden of administration and bureaucracy for charities would increase. Any existing charity seeking to claim gift aid, or any other tax relief or exemption (for the first time or following a dormant period of years in terms of tax claims) now needs to submit an application to register with HMRC. Even if an organisation is already registered with HMRC and is entitled to claim tax reliefs and exemptions, it is now required to notify HMRC of a number of changes in its administration.

On the other hand, some hold the view that the administrative burden for charities has actually reduced following the introduction of the 'fit and proper person' test, because HMRC has been required to adopt a more formal procedure.<sup>19</sup> HMRC has also produced a number of standard forms that can be used in order to make the applications more straightforward.

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<sup>19</sup> Prior to the Finance Act 2010, there was no formal process by which HMRC assessed whether an organisation qualified for charitable reliefs. The standard practice consisted in a series of letter exchanges whereby HMRC asked the charity for information such as evidence of being registered and type of charitable activities.

There is also the concern that the practices, once established, will start to mirror those already carried out by the Charity Commission and therefore be a cause of duplication. Concerns have also been raised about the value of the model declaration: as a self-certification procedure, it is doubtful that this process will significantly reduce fraud.

### **Tainted Donations Rules**

The 'tainted donations rules' are another example of HMRC's approach to regulating charities. These are intended to replace previous anti-avoidance legislation on substantial donations to charities, and are contained in the Finance Bill 2011. However, the new rules further demonstrate HMRC's propensity to introduce layers of legislation that would not be necessary if existing tax rules were properly enforced.

The new rules are intended to deter the abuse of charity tax reliefs while avoiding the drawbacks of the previous legislation.<sup>20</sup> In particular, the rules have introduced a 'purpose test' designed to catch only donors who, in respect of a donation to charity, have entered into arrangements with the purpose of receiving an advantage from the charity.

Although the 'tainted donations rules' are a significant improvement, HMRC has yet to provide any example of a transaction that the new legislation is intended to address and is not already covered by the existing charitable expenditure rules or other existing anti-avoidance legislation. The starting point for any law reform, including any anti-avoidance legislation, is to identify clearly the problem which needs to be addressed. If any gap in existing legislation is identified, the next step should be to see if existing provisions can be amended to cover the situation. The starting point should not be to devise a new and complex anti-avoidance system which is added to existing anti-avoidance rules.

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<sup>20</sup> The substantial donor rules were introduced by the Finance Act 2006 with the apparent aim of preventing the abuse of charity tax reliefs in transactions between charities and individuals who donated substantial amounts of money. However, the rules were drafted in a very wide-reaching manner and their operation effectively penalised a large number of innocent transactions, as well as causing a considerable administrative burden for charities, which were expected to identify substantial donors, connected persons and transactions which might fall within the legislation.



## **Self Regulation and Good Practice**

Charities themselves have recognised fraud as a problem that undermines the stability and financial health of their organisations. While the financial implications are cause for serious concern, it is also important to consider the impact on the reputation of individual charities, and the risk to the integrity of the sector as a whole. Charities rely on their reputation and good name to obtain financial support, and therefore understand the need to be accountable to a range of stakeholders, including beneficiaries, donors, and the wider public, over and above any formal regulatory requirements. At a time when public trust and confidence in many social institutions appears to be declining, charities know that they must not only convince people that their cause is worthy, but also demonstrate that they can be trusted to make a positive difference by using charitable money to further good causes.

For all these reasons, it is crucial for charities to have appropriate policies and procedures in place to mitigate the risks to their reputation as far as possible. This should include consideration of the organisation's response to fraud and how this is communicated to stakeholders and the general public. Outlined below are some initiatives led by the sector itself to develop good practice around fraud prevention.

### ***The Fraud Advisory Panel***

Established in 1998 through an initiative led by the Institute of Chartered Accountants, the Fraud Advisory Panel is a registered charity with the aim of reducing harm caused by fraud and financial crime. It achieves this in two ways: by raising awareness on the extent and nature of fraud, as well as the damage it causes; and through helping organisations develop fraud management strategies, by providing best practice advice on fraud prevention, detection and investigation.

For example, the FAP has developed a 'four point action plan'<sup>21</sup> for charities wishing to protect themselves from fraud.

### ***Code of Good Governance***

For many years voluntary sector umbrella bodies have undertaken extensive work to promote good governance and trusteeship, for example producing the Code of Good Governance for charity trustees.<sup>22</sup>

<sup>21</sup> Fraud Advisory Panel *4-point action plan for charities*. Available at <http://www.fraudadvisorypanel.org/new/fraud-charities.php?PHPSESSID=2720bfeb8daccb3ea01e570cfa97b7aa#4point>.

<sup>22</sup> ACEVO, Charity Trustee Networks, Institute of Chartered Secretaries and Accountants, and NCVO Steering Group (October 2010) *Good Governance: A Code for the Voluntary and Community Sector*. Available at <http://www.goodgovernancecode.org.uk/>.

One of the key principles set out by the Code is that the board should be able to 'exercise effective control', including good internal financial and management control. In order to achieve this, the Code recommends that the organisation should regularly identify and review the major risks to which it is exposed, and places systems to manage those risks. Although not explicitly mentioned, this obviously includes the risk of fraud.

### ***Good Trustee Guide***

The Good Trustee Guide<sup>23</sup> is another sector led initiative that provides comprehensive guidance on a trustee's role and developing an effective board. Once again, fraud is not specifically addressed as a problem, but a number of recommendations are provided with regards to good financial management and control. These are also useful for fraud prevention.

For example, as part of their duties, trustees must 'safeguard the charity's property from loss or damage'. The guide suggests that one way to fulfill this duty is by maintaining adequate insurance cover. This can include 'fidelity insurance' so that the organisation is protected from the loss of money resulting from dishonesty by employees, including fraud.

### ***Guide on 'Duties of Charity Trustees'***

This guide<sup>24</sup> is more explicit about what trustees should do to guard their charity against fraud and mismanagement, as part of their primary responsibility of safeguarding and protecting the charity's resources. The guide explains that a charity should put proper financial procedures in place, covering everything from budgeting to cheque authorisation, and trustees should monitor the implementation of these procedures. If money is lost as a result of fraud, the trustees will be expected to explain to the Charity Commission what steps were taken to prevent this occurring and why they did not work.

Notwithstanding these initiatives, according to the most recent surveys there are still a number of gaps in the basic risk management components for many charities. The key findings in relation to charities' risk management<sup>25</sup> showed that the majority (54%) of voluntary sector organisations do not have a counter-fraud strategy.

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<sup>23</sup> NCVO (October 2008) *The Good Trustee Guide*.

<sup>24</sup> Bates Wells & Braithwaite LLP (September 2010) *Duties of Charity Trustees*. Available at <http://www.bwbllp.com/Files/Publications/DutiesOfCharityTrustees2010.pdf>.

<sup>25</sup> PKF in association with the Charity Finance Directors' Group *Managing Risk, Moving Towards the Vision – The PKF Charities Risk Survey Findings 2010*. Available at: [http://www.pkf.co.uk/pkf/publications/charity\\_risk\\_report#](http://www.pkf.co.uk/pkf/publications/charity_risk_report#).

Furthermore, when looking at the resilience to fraud within the voluntary sector<sup>26</sup>, it is reported that 76% of voluntary sector organisations don't regularly review the effectiveness of their counter-fraud work (compared to 43% of public sector bodies, and 50% of private sector companies).

When comparing the implementation of formalised fraud policies within the private, public and voluntary sectors it should be recognised that the vast majority of charities are small and have no staff<sup>27</sup>. Therefore it is unlikely that small charities will have the resources to establish specialised fraud prevention measures. However in most cases, the absence of a formal strategy does not necessarily indicate a lack of internal financial management controls that in practice prevent fraud or other abuses from occurring.

On the other hand, the Charity Commission's report from its compliance work ('Charities Back on Track') does make the case for charities' governance systems needing to be more active when addressing potential threats of fraud. While the report is positive in many respects, demonstrating that only in comparatively few cases the problems affecting the sector were so serious that they required full investigation<sup>28</sup>, there is concern about the number of charities put at undue risk of abuse or harm as a result of weak governance and poor management. When specific issues of fraud and theft were detected,<sup>29</sup> the main causes were the failure by trustees to properly govern, poor financial management, lack of financial controls and inadequate accounting, record keeping and reporting. These continue to be problematic areas especially within smaller charities, which is even more worrying as they can least afford the cash or reputational costs of even a minor fraud.

Therefore, there is reason for the charitable sector as a whole to take a much more rigorous approach to tackling fraud, and for all charities regardless of size to be vigilant. Larger organisations with available staff and resources should play a proactive role in developing good practice and adopting strategic prevention measures. But even small charities with relatively simple structures and low-risk activities need to be aware of the threats to their resources and to protect their assets, for example by applying a common sense approach to their affairs and avoiding being too trusting.

By adopting this type of behaviour, it is more likely that any future measure intended to address the risk of abuse of charities takes account of the safeguards already enacted by the sector, and therefore does not undermine the activity and reputation of bona fide legitimate charities which are of vital importance to society.

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<sup>26</sup> PKF (January 2001) *The resilience to fraud of UK Plc – Comparing the private, public and voluntary sectors*. 376 organisations from across the public, private and voluntary sectors responded to a survey questionnaire about the effectiveness of their arrangements to counter fraud. Available at: [http://www.pkf.co.uk/web/pkf.nsf/AAE8EAAE86B019ED80257846004E72A7/\\$file/UK+Fraud+Resilience+Report.pdf](http://www.pkf.co.uk/web/pkf.nsf/AAE8EAAE86B019ED80257846004E72A7/$file/UK+Fraud+Resilience+Report.pdf).

<sup>27</sup> In 2007/08 there were over 171,000 active voluntary organisations in the UK, the majority of which (over 91,000) can be classified as 'micro', that is with an annual income of less than £10,000.

<sup>28</sup> According to the report in the period covered (2009-2010), only 180 (0.1%) of the 180,000 charities on the Commission's Register were subject to investigations opened during the period covered.

<sup>29</sup> According to the findings in the report, fraud and theft featured in: 245 of 2615 assessments (9% of the total); 9 of 180 investigation cases opened during the year (5%); 175 out of 451 reports of serious incidents (39%) and 21 out of 53 whistle blowing reports (39%).

## **Conclusions and Recommendations**

The Task & Finish Group recognises the threat to charities posed by fraudulent activity, and the need for effective action to address this problem. There are real concerns about the potential abuse of charities for financial criminal purposes, and the threat of tax fraud involving charities must be taken seriously.

It is the duty of Government to ensure that occurrences of fraud are reduced to a minimum, and it is in the interest of our sector that the good name of charity is maintained, by ensuring our organisations are not open to abuse.

However, it is important that any measures motivated by legitimate concerns around fraud should be sensitive and proportionate, and ensure that charitable endeavour is not stifled by red tape whilst maintaining general confidence in the sector on the part of donors, funders, beneficiaries and the general public. In the past, there has been a tendency to adopt an approach that tarnished charities as a whole, without offering any clarification of the true scale of the problem or any evidence of wrongdoing. As a consequence, the resulting measures were often ineffective and even counter-productive, because they were not sufficiently targeted on specific risks and vulnerabilities.

The changes introduced by the Finance Act 2010 came without warning and therefore caused understandable alarm within the charitable and legal sectors. Due to the lack of consultation leading to the Act and related guidance, there was a lot of confusion about what the new rules meant for charitable organisations and their governing boards. This could have easily been avoided by engaging the sector more widely and ensuring better quality guidance from HMRC since the beginning.

Since the original version of the guidance was first published, HMRC has been prompted in part by the group's creation and in part by wider sector debates to carry out a number of revisions and amendments aimed at improving the both the information provided and the application of the 'fit and proper person' rules. This has led to a welcome clarification of some issues, such as the fact that all charities already approved for gift aid before the introduction of the new rules are not required to reapply, and that the individuals who qualify as 'managers' will not be routinely asked to demonstrate they are 'fit and proper persons' but can generally assume they meet the management condition. Another positive substantive change is the introduction of a formal appeal process beyond the internal complaints procedure. This has considerably appeased previous concerns for the civil rights of individuals who have been judged not 'fit and proper'.

However, concerns remain over the additional bureaucratic burden that compliance with the new test will place on charities and the lack of clear objective criteria for assessing a manager's fitness. Furthermore, it is neither helpful nor satisfactory that the Finance Act 2010 and relative HMRC guidance have introduced fundamentally important definitions, such as those to describe 'the persons having the general control and management of the administration of the body or trust' and the meaning of 'charity', that are inconsistent with and parallel to those already operated by the Charity Commission.

These misgivings confirm the need for Government to better consult the sector to ensure that the risk of charities being involved in fraud is addressed in the most effective way. Initiatives should be developed with the involvement of the sector, in order to properly take into account how charities work and the environment in which they operate.

To help improve the regulatory framework in which charities currently operate, the Task & Finish Group makes the following recommendations that should enable both the Charity Commission and HMRC to carry out effectively their respective roles in fraud prevention, and therefore maintain public trust and confidence in the charity 'brand', while at the same time minimising the administrative burden on charities.

**1. *The charity and community sector should be involved and consulted effectively***

The Task & Finish Group welcomes HMRC's willingness to engage in talks with the sector and amend its guidance in accordance with the concerns expressed. Encouraged by this goodwill, the Group would like to highlight the importance of ensuring that in future there is proper and meaningful dialogue between the sector and Government, in compliance with the principles set out by the Compact. It is essential that all Government departments involve and consult the charity and community sector effectively, from the earliest stages of policy development and legislative change. By ensuring proper engagement, Government will be able to make informed decisions that result in better outcomes for all stakeholders.

**2. *Any legislative and regulatory measure must be proportionate and evidence based***

Existing legal and regulatory requirements on charities must be properly considered before new duties are imposed. Any new measure must be proportionate and evidence based, building upon the existing system of charity law and regulation.

**3. *The importance of the Charity Commission's role as an independent civil regulator must be recognised***

Government should be considerate of the valuable oversight already provided by independent civil regulators such as the Charity Commission. The fact that the Charity Commission operates independently of both Government and the charitable sector is essential to safeguard public trust and confidence in the sector, and the integrity of the charity 'brand'. An independent regulator acts in the public interest, meaning it is sheltered from prevailing political pressures on the one side (and therefore has the confidence of charities, donors, beneficiaries and the wider public), and does not get too closely identified with charities on the other. In this position, the Commission is uniquely placed to undertake an objective assessment of the potential risks to the sector and to individual charities where there is evidence of mismanagement, fraud or abuse.

**4. *The Charity Commission and HMRC should look at ways of improving their information sharing, such as establishing information ‘gateways’***

The Charity Commission and HMRC should work together to improve access to information and create ‘gateways’ where duplication has been identified. Gateways provide a single point of access to a specific set of information, and by allowing them the Charity Commission and HMRC would make a considerable contribution towards the simplification and automation of dialogue. In the longer term, it would be desirable that the Charity Commission, HMRC and other relevant bodies (such as Companies House for example) explore ways of setting up a joint online system which would act as a ‘one stop’ for charities. This single database would help towards easing the current burdens on charities caused by repeated requests for the same type of information, while at the same time allowing efficiency and cost savings to governmental and non-governmental departments.

**5. *The new ‘fit and proper person’ test must be applied in an objective and reasonable way***

HMRC’s guidance should be amended so that a decision on whether an individual meets the ‘fit and proper person’ test is based on a standard that ensures the test is applied in a manner that is objective and reasonable. Measures should also be put in place in order to ensure HMRC is properly accountable for the judgements it makes.

**6. *The Gift Aid system should enable charities to file claims entirely online***

The Task & Finish Group welcomes HMRC’s launch of a new Gift Aid toolkit whereby forms can be downloaded from the website. However, HMRC should take further steps to update its software so that applications for Gift Aid approval can also be completed and submitted online. This would enable charities to complete and return forms without the need to download documents and send them through the post.

**7. *All charity tax guidance should have version control software to enable any changes to be tracked***

HMRC should take the necessary steps to set up version control of its guidance on the ‘fit and proper person’ test and other charity tax guidance. Version control software allows the management of changes to documents, by identifying the change and associating each revision with a timestamp and the person making the change. This would provide reassurance to those relying on the guidance that they have a legitimate expectation to not be pursued even if the guidance is subsequently changed.

**8. *The law relating to the disqualification of trustees should be included in the review of the Charities Act 2006***

The law relating to the disqualification of charity trustees should be subject to the review of the Charities Act in Autumn 2011. In particular, consideration should be given as to whether the power of the Charity Commission under s18 of the 1993 Act to suspend or remove a trustee requires any extension to provide an option of

temporarily suspending individuals who are subject to an investigation by HMRC into whether they are 'fit and proper' to be a charity manager.

**9. *The provisions on disclosure of information between the Charity Commission and HMRC should be included in the review of the Charities Act 2006***

Cooperation between the Charity Commission and HMRC should be improved in order to enable both bodies to better discharge their functions. In particular, the provisions on disclosure of information in s10 of the 1993 Act should be included in the review of the Charities Act 2006. HMRC should be allowed the option of disclosing information to the Charity Commission not only if it relates to a charity, but also personal taxation issues when the individual concerned is a member of the charity's governance board.

**10. *HMRC and the Charity Commission should engage the sector to develop and promote good practice and self-regulation***

HMRC and the Charity Commission should work with the sector to develop and disseminate good practice and promote sector led initiatives that enable charities to develop effective responses to fraudulent activity. Where appropriate, there should be an emphasis on self regulation and on existing measures taken by individual charities to mitigate the specific risks faced by their organisation.

**11. *Relevant sector bodies should take steps to increase awareness of existing financial control measures***

Building on their expertise and previous work, relevant sector bodies should continue to increase public awareness and understanding of existing regulation and of the financial control measures already developed within the sector, in order to spread good practice and ensure public trust and confidence in the sector is maintained. The Task & Finish Group in particular welcomes the recent announcement by the National Fraud Authority that, in refreshing the National Fraud Strategy, it will seek the engagement of representatives from the charity sector in order to secure a greater understanding of the commitments and plans the sector already has in place.

**12. *Relevant sector bodies should consult with charities to develop appropriate models of counter-fraud and financial control mechanisms***

Charity practice in relation to preventing fraud should be strengthened. Relevant sector bodies should consult and work in collaboration with charities of different size and income to develop models of counter-fraud mechanisms, and broader financial controls.

**13. *The importance of anti-fraud mechanisms within good governance should be emphasised***

To further strengthen the role of anti-fraud mechanisms as part of good governance, the revised Code of Good Governance for the voluntary and community sector

should include a reference to the responsibilities of trustees in setting up mechanisms to prevent and detect fraud.



## **ANNEX I - Task & Finish Group Terms of Reference**

1. Secretariat support to the group is to be provided by the Policy Team at NCVO.
2. Lord Raymond Plant has been invited to act as Chair and spokesperson for the group.
3. Members of the group are to be invited from a cross-section of relevant Government departments, Parliament, regulatory authorities, and representatives of key voluntary sector infrastructure organisations.
4. A broad range of technical and legal experts are to be invited to offer evidence and advice on each of the issues identified by the group.
5. The group is to have a EU wide focus, with international comparative analysis.
6. The group will meet at least once in plenary to frame the questions that need to be addressed. Further work can be continued through e-mail contact.
7. The final report is to be approved by the whole group either through e-mail or in a second plenary meeting.
8. The Task and Finish Group is asked to:
  - a. assess the importance of the role of the charity regulator, particularly in the context of developments in European jurisprudence and cross border giving;
  - b. investigate the level and type of fraud affecting the charitable sector;
  - c. analyse the role of the Charity Commission and HMRC in relation to fraud and the levels of protection they provide to charities, including the process they follow in carrying out this role and whether it is sufficiently transparent;
  - d. examine whether there is overlap between HMRC and the Charity Commission, and whether the measures taken by HMRC are proportionate and effective when applied to the charity sector;
  - e. examine the regulatory impact of the new HMRC measures, including the 'fit and proper' test on charities, how it is applied in other pieces of legislation and what appeal mechanisms are available for the individual concerned;
  - f. on the basis of the evidence and findings above, provide any further recommendations to minimise red tape and decrease the regulatory burden on charities.
9. The Task and Finish Group is to produce a report which will set out its findings and recommendations. The report is expected to be finalised in early 2011.
10. The Task and Finish Group will be operating in parallel to the Government De-Regulation Taskforce run jointly by the Office for Civil Society and the Department for Business, Innovation and Skills. The Task and Finish Group findings will be made available to the governmental task force.
11. The group will agree key messages to be used in media work. Media releases are to be prepared by the NCVO and Lord Plant as Chair and spokesperson will be responsible for agreeing all media output.

## **ANNEX II - Task & Finish Group Members**

### **Lord Raymond Plant**



Lord Plant is Professor of Jurisprudence at King's College law School. He has been a member of the House of Lords since 1992, and was President of NCVO from 1998 to 2003. Lord Plant is the author of 11 books on political and legal philosophy, the latest being 'The Neo Liberal State' (published by Oxford University Press, 2010). Amongst other important roles, Lord Plant was also Master of St Catherine's College Oxford from 1993 to 2000, and is Lay Canon of Winchester cathedral.

### **Baroness Maeve Sherlock**



Maeve Sherlock has been a member of the House of Lords since July 2010. She has spent most of her career in the voluntary sector, heading a number of voluntary organisations, most recently The British Refugee Council. Maeve spent three years as a member of the Council of Economic Advisers, advising Treasury ministers on a range of issues including families with children, the labour market and the voluntary sector. During the 2007 Spending Review, Maeve chaired an Advisory Panel advising ministers on the future role of the Third Sector in economic and social regeneration. She was also a member of the Carnegie Commission of Inquiry into the Future of Civil Society and has chaired the judges for The Charity Awards for the last three years. Maeve is a Non-Executive Director of the Financial Ombudsman Service.

### **Sir David Varney**



Following a high profile career in the private sector, Sir David Varney became Chairman of HM Revenue and Customs from its establishment in April 2005. He was awarded a knighthood in the 2006 New Year's honours list. David stood down in September 2006 to take up the role as Senior Advisor to the Chancellor on Service Transformation. He was the Prime Ministers advisor on Public Service Transformation from 2007 to 2009. From January to June 2010 Sir David was Chair of Barking, Havering and Redbridge University Hospitals Trust. Other public roles have been as Chairman of Business in the Community and President of the Chartered Management Institute.

## **Sir Stuart Etherington**



Sir Stuart Etherington was appointed Chief Executive of NCVO in 1994. Previously he was Chief Executive of the Royal National Institute for Deaf People.

Stuart is Pro-Chancellor of Greenwich University, a Council Member of the Institute of Employment Studies, an Advisory Group member for the Policy Centre at the British Academy and a member of the Economic and Social Committee of the European Union. He has been a trustee of Business in the Community, the Chair of the BBC Appeals Advisory Committee, a member of the Community and Social Affairs Committee of Barclays Bank, former Chair of Guidestar UK, Chair of CIVICUS Europe, and Treasurer of CIVICUS. His Government appointments have included the Prime Minister's Delivery Unit. He has also served on the Cabinet Office Performance and Innovation Unit's Advisory Board on the Voluntary Sector and HM Treasury's Cross Cutting Review on the role of the Voluntary Sector. In June 2010 Stuart received a knighthood in the Queen's birthday honours in recognition of his work on behalf of the voluntary and community sector.

## **Caron Bradshaw**



Caron has been the Chief Executive Officer at CFGD since June 2010. Previously she was Head of the Charity and Voluntary Sector at the ICAEW, and had responsibility for shaping the ICAEW's engagement with the sector and delivery of technical and member support.

Having trained as a Barrister, Caron held a variety of roles at the ICAEW during 16 years including providing front line support to members as Head of the Ethics Advisory Service and technical/policy input as a Business Law Manager. Caron has been involved with a number of small charity and community organisations throughout this period.

## **Lindsay Driscoll**



Lindsay is a solicitor and has spent over thirty years in the field of charity law and governance, both in this country and in many countries throughout the world. She is now a consultant with Bates Wells and Braithwaite and prior to this she was a Legal Commissioner at the Charity Commission. Previous positions include a partnership with Sinclair Taylor and Martin, Head of Legal and Governance at NCVO and Assistant Registrar General in Kenya. Lindsay has written and lectured extensively on charity law and governance issues and currently chairs the steering group of the

Code of Good Governance and is on the board of several charities and non profits including the International Center for Not for Profit Law based in Washington.

### **John Stoker**



John Stoker is a freelance consultant to public, lottery and voluntary sector clients specializing in management and governance review. He is a trustee of the Institute of European Environmental Policy and of three charity common investment funds, a member of the Court of the University of Greenwich and a Director of the Responsible Gambling Fund. He was the founding Chief Executive of the Mayor's London Bombings Relief Charitable Fund, which won the 2006 annual Charity Award for effectiveness. He was a member of the Solicitors Regulation Authority from 2005 to 2009 and Chief Charity Commissioner from 1999 to 2004. He joined the National Lottery regulator OFLOT in 1997, becoming Director General in 1998.

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**Baroness Angela Browning** was a member of the group between September 2010 and April 2011.

Baroness Browning was raised to peerage in May 2010. Since September she has also been a Commissioner on the Board of the Electoral Commission.

From 2005 to 2007 Browning was Deputy Chairman of the Conservative Party, with responsibility for Party organisation and campaigning. She also served as Shadow Leader of the House of Commons and Constitutional Affairs from 2000 to 2001. Previously she was a Vice Chairman of the Conservative Party.

Baroness Browning is Vice-President of the National Autistic Society and National Vice-President of the Alzheimer's Disease Society.

## **ANNEX III – Finance Act 2010 (Schedule 6)**

### **Registration condition**

- 3 (1) A body of persons or trust meets the registration condition if—
- (a) in the case of a body of persons or trust that is a charity within the meaning of the Charities Act 1993, condition A is met, and
  - (b) in the case of any other body of persons or trust, condition B is met.
- (2) Condition A is that the body of persons or trust has complied with any requirement to be registered in the register of charities kept under section 3 of the Charities Act 1993.
- (3) Condition B is that the body of persons or trust has complied with any requirement under the law of a territory outside England and Wales to be registered in a register corresponding to that mentioned in sub-paragraph (2).

### **Management condition**

- 4 (1) A body of persons or trust meets the management condition if its managers are fit and proper persons to be managers of the body or trust.
- (2) In this paragraph “managers”, in relation to a body of persons or trust, means the persons having the general control and management of the administration of the body or trust.

### **Periods over which management condition treated as met**

- 5 (1) This paragraph applies in relation to any period throughout which the management condition is not met.
- (2) The management condition is treated as met throughout the period if the Commissioners for Her Majesty's Revenue and Customs consider that—
- (a) the failure to meet the management condition has not prejudiced the charitable purposes of the body or trust, or
  - (b) it is just and reasonable in all the circumstances for the condition to be treated as met throughout the period.

## ANNEX IV – HMRC’s Detailed guidance on the Fit and Proper Persons test

(revised February 2011)

The guidance is available at:

<http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/fp-persons-test.htm>

### Who should read this guidance?

This guidance is for trustees of charities, directors of corporate charities and any employees of a charity and volunteers who:

- act on behalf of a charity
- are involved in appointing people to act on behalf of a charity

to claim tax reliefs or to exert control over spending the charity’s funds.

### Introduction

The Finance Act 2010 introduced a new definition for tax purposes of charities and other organisations entitled to UK charity tax reliefs (referred to as 'a charity' or 'charities' in this guidance). The new definition includes a requirement that to be a charity an organisation must satisfy the 'management condition'.

The new definition applies to Gift Aid with effect from 1 April 2010. The new definition will be extended to other charity tax reliefs in due course. It follows that this guidance applies at present only to charities claiming repayments of tax under Gift Aid.

The management condition applies, with appropriate amendments, to Community Amateur Sports Clubs (CASCs) as well as to charities. As a result the guidance below applies to CASCs as it applies to charities.

For a charity to satisfy the management condition its managers must be fit and proper persons. There is no definition in the legislation of a '**fit and proper person**'. This guidance explains how HM Revenue & Customs (HMRC) applies this test to those who have the general control and management of the administration of the charity.

**HMRC assumes that all people appointed by charities are fit and proper persons unless they hold information to show otherwise. Provided charities take appropriate steps on appointing personnel then they may assume that they meet the management condition at all times unless, exceptionally, they are challenged by HMRC.**

Where HMRC finds a manager of a charity is not a fit and proper person, a charity will not necessarily lose entitlement to the charity tax reliefs. As explained below, HMRC is able to treat a charity as having met the management condition where either the manager has no ability to influence the charitable purposes of the charity or the application of its funds, or the circumstances are such that it is just and

reasonable to treat the charity as having met the management conditions throughout the period the manager has been in office.

**A charity's tax reliefs and exemptions will not be withdrawn during an enquiry into whether it meets the management condition.** HMRC may however decide not to make repayments of tax during an enquiry, depending on the circumstances. Where the management condition is found to be satisfied, or HMRC treats the management condition as being met, throughout the period then the charity will qualify for tax reliefs and exemptions throughout the period. HMRC will make any outstanding repayments at the conclusion of that enquiry.

### **Why introduce the fit and proper persons test?**

The fit and proper persons test makes it harder for sham charities and fraudsters working within a charity, or targeting a charity from outside, to abuse charity tax reliefs. It is not intended as something to deny tax reliefs to charities who make a genuine mistake. Many of the charity tax reliefs work by clawing back tax where the charity has not applied donations or other income or gains for charitable purposes – a 'look back' system where tax reliefs and exemptions are given in advance. Where a genuine charity makes a mistake it is usually easy for HMRC to recover the tax due. However where fraudsters have hijacked a charity or are operating within a charity it may be impossible to recover the tax due.

**The fit and proper persons test provides for HMRC to exercise its discretion to allow relief even where the fit and proper persons test has been breached, where a charity can show it made a genuine mistake and there has been no misuse of charity tax reliefs.** This guidance is therefore intended to help charities understand how the test works and what they need to do to ensure they do not lose their tax reliefs.

### **Who does the fit and proper persons test apply to?**

The fit and proper persons test applies to the 'managers' of the charity. The term 'manager' is defined in the legislation as the persons having the general control and management of the charity and, for the purposes of this legislation, applies to the trustees of charities, directors of corporate charities, CASC officials, and any other persons having general control and management over the running of the charity or the application of its assets.

The term 'general control and management' has a wider scope than that found in the Charities Act 1993, which applies only to trustees of a charity. For example:

- In a typical small local charity a manager for the purposes of the fit and proper persons test could include the Chairperson, Treasurer, Secretary and the rest of the management committee who would have control over expenditure.
- In a larger charity a manager for the purposes of the fit and proper persons test would include all trustees or directors of a corporate charity but may also extend to certain employees who are able to determine how a significant proportion of the charity's funds are spent. For example, most large charities

have a Board of Trustees and an Executive Board of senior employees. In such a case the trustees and members of the Executive Board would be managers of the charity.

**HMRC takes the view that charities will have given proper consideration to the suitability of their managers to act in such capacity, and that consequently those managers are fit and proper persons.**

However, where HMRC becomes aware of information that suggests that a charity's managers are not fit and proper persons, HMRC will raise its concerns with the manager initially and later, if appropriate, with the charity, even if the charity regulator has not identified the manager as not being a fit and proper person. HMRC may become aware of such information from information it already holds or is passed to it. For example HMRC may be aware a certain individual has been involved in fraudulently claiming tax credits. If it sees that same individual appointed to the management committee of a small local charity HMRC would want to explore the extent to which the individual was able to exert control over the charity's finances and tax affairs.

As explained below, whilst the definition of managers can cover a wide range of individuals in a charity, charities do not need to notify HMRC about all managers or all changes of managers.

### **What is the fit and proper persons test about?**

The 'fit and proper persons' test is concerned with ensuring that charities are not managed or controlled by individuals who present a risk to the charity's tax position.

If a charity regulator does not consider that an individual is suitable to be a trustee of a charity that individual will not be able to satisfy the fit and proper persons test.

However, it does not necessarily follow that individuals who are considered by a charity regulator to be suitable to act as trustees of charities will always be considered to be fit and proper persons for the purposes of the management condition. This is because different charity regulators have different responsibilities and priorities from those of HMRC and therefore carry out different sorts of checks on individuals. Also, HMRC has access to certain information that is not available to charity regulators. So, as explained below, to ensure a consistent approach across all individuals, HMRC tailors its checks to cover areas that are not covered by charity regulators and considers additional information to which the regulators may not have access.

Factors that may lead to HMRC deciding that a manager is not a fit and proper person include, but are not limited to, individuals:

- with a history of tax fraud
- with a history of other fraudulent behaviour including misrepresentation and/or identity theft
- for whom HMRC has knowledge of involvement in attacks against or abuse of tax repayment systems



- barred from acting as a charity trustee by a charity regulator or Court, or being disqualified from acting as a company director

However, just because an individual has been, say, barred from acting as a charity trustee or one of the other points above applies, it does not follow that the charity will always fail the management condition. This is explained further below.

### **What happens if a manager is not a fit and proper person?**

A charity may claim charity tax reliefs only if it meets the management condition. It will meet the management condition if all of its managers are fit and proper persons.

HMRC also has the discretion to decide whether the management condition is to be regarded as satisfied during a period where one or more managers are not fit and proper persons. HMRC may apply this discretion if it considers that **either**:

- the manager is not able to influence the charitable purposes of the charity or the application of its funds
- the circumstances are such that it is 'just and reasonable' to treat the management condition as being met

The guidance below explains how HMRC will apply its discretion in practice.

### **When will HMRC consider a manager cannot influence the charitable purposes of the charity or the application of its funds?**

When considering the application of the fit and proper persons test to particular managers, HMRC will take account of the likely impact on the charity's tax position. The position that the person holds within the organisation will be very important as those with greater control over how the charity tax reliefs are claimed, processed and used will clearly present a greater risk than those with no such control. As a result the checks HMRC applies will vary from case to case, depending on individual circumstances.

HMRC considers that any person who has no dealings with HMRC and no control over spending charity funds, even if the person is not a fit and proper person, is unlikely to affect the charity's eligibility to tax reliefs and the charity is therefore likely to meet the management condition.

As an example, charities concerned with the rehabilitation of offenders may knowingly appoint ex-offenders to management positions within the charity. In such a case HMRC will apply the fit and proper test flexibly:

- If the person might not be considered to be a fit and proper person but is not able to exert control over the charity's finances and tax affairs then HMRC will consider that a person cannot affect the charitable purposes of the charity and the charity would be treated as meeting the management condition. For example this would happen if the person was on the management committee but not on the finance committee of the charity, had no access to charity funds and could not authorise expenditure without the approval of the full management committee and was not in a position to otherwise unduly influence financial decision making.

- If the charity wishes to give the person some financial responsibility, such as making claims to tax relief on behalf of the charity then, provided the charity puts into place adequate controls, HMRC may accept the person as being fit and proper for the purposes of the management condition. However in such cases the charity should advise HMRC of the circumstances when they notify HMRC of the appointment. In appropriate cases HMRC will work with the charity in an attempt to ensure that eligibility for the charity tax reliefs continues.

**When will HMRC consider the circumstances are such that it is just and reasonable to treat the management condition as being met?**

Where a charity unknowingly appoints a person who is not a fit and proper person to a position where they have dealings with HMRC, or control over spending charity funds, the charity will not necessarily lose access to charity tax reliefs.

For example, if HMRC identified a manager who was not a fit and proper person to hold a position giving them influence over the finances of the charity, and either:

- the charity moves that person from that role, to, say, another role where they would not have influence
- puts in place close supervision of the person's activities in relation to their financial activities on behalf of the charity

then HMRC has the discretion to treat the charity as having met the management condition throughout the period of the manager being in office. As a result the charity will not lose its entitlement to the charity tax reliefs during that period. However, if a charity does not amend its organisation in response to an approach from HMRC then HMRC may refuse the charity's claims to reliefs.

If a charity has innocently appointed a manager who is not a fit and proper person, and that person has misapplied some of the charity's funds, without the charity's knowledge, the charity will not necessarily be denied charity tax reliefs and exemptions. Whilst the charity will have appointed a manager who is not fit and proper, and the charity's funds will have been affected, where the charity can demonstrate that it had taken reasonable steps and was not party to the misapplication of funds then HMRC will work with the charity in an attempt to correct the position.

**How will HMRC apply the fit and proper persons test?**

HMRC does not offer a clearance service for charities to confirm that particular managers are fit and proper persons. HMRC will generally assume that charities have given proper consideration to the suitability of their managers to act in such capacity, and that consequently those managers are fit and proper persons.

If, exceptionally, a charity appoints a person whom the charity considers may not be a fit and proper person (for example a convicted fraudster) to a position where the person is able to exert control over the charity's finances and tax affairs, the charity should explain in a letter the circumstances of that appointment. HMRC will work

with the charity to help them meet the management condition, for example by agreeing what level of supervision of the person's activities would be required.

HMRC applies a risk-based approach to its activities and carries out full checks where there appears to be a high risk of non-compliance, including where it receives information of potential fraud.

Where a charity is regulated by a charity regulator in its home country HMRC also takes into account the checks that the regulator has carried out on any managers, to ensure that checks are not duplicated. However, if the individual has not been subject to previous checks, or is based in a country where there is no other regulation of the organisation, then, depending on the potential risks presented, the checks that HMRC carries out may need to be extensive. As a result such checks may take some time to complete.

### **What will happen to the manager if HMRC doesn't think they are fit and proper?**

HMRC would always encourage a person who is appointed as a manager of a charity to be open and honest with the charity to prevent problems arising. If the charity knows a person may fail the fit and proper persons test they can seek early advice from HMRC about what to do to prevent any loss of tax reliefs.

Where the charity has not already approached HMRC but HMRC is concerned that a manager may not be a fit and proper person HMRC will notify that person of the grounds for concern and give them the opportunity to challenge HMRC's view. The person may wish to include the charity in the discussions with HMRC but there is no obligation to do so.

If following the discussions HMRC continues to consider the person is not a fit and proper person, and also considers that it would not be appropriate to exercise its discretion in relation to the management condition, HMRC will notify the person in writing of their decision.

If the person is dissatisfied with HMRC's decision that they are not a fit and proper person they can ask for that decision to be reviewed by a senior manager in HMRC Charities. The person should write to the 'Fit and Proper Persons Test Review Manager, HMRC Charities, St John's House, Merton Road, Bootle, L75 1BB'. Which senior manager reviews the case will depend on who in HMRC took the decision the person was not 'fit and proper'. The decision would normally be reviewed by a manager not involved in the original decision.

If the reviewing manager in HMRC Charities considers the original decision was correct and the person is still dissatisfied with HMRC's decision that they are not a fit and proper person they can ask for that decision to be reviewed again by the Head of HMRC Charities. The individual should write to the 'Head of HMRC Charities, St John's House, Merton Road, Bootle, L75 1BB'.

If the Head of HMRC Charities upholds the decision and the person is still dissatisfied then they can ask the Adjudicator to look into the case. The Adjudicator is a fair and unbiased referee, and the service is free. The Adjudicator will only look at the complaint after it has been considered by the Head of HMRC Charities.

The Adjudicator's Office looks into complaints about mistakes and the use of discretion in HMRC (amongst other issues). A complaint should be raised with the Adjudicator's Office within six months of a decision by the Head of HMRC Charities, and the Adjudicator aims to reply to initial contact within 10 days. The Adjudicator's Office will need certain information such as contact details, as well as details about the specific complaint being made (see the Adjudicators Office website). A friend, relative or professional adviser may represent the person (but the person must submit written authority to the Adjudicators Office first).

The Adjudicator's Office will initially screen the person's complaint and if content that HMRC has had sufficient opportunity to consider the position fully (that is the Head of HMRC Charities has given their decision) the Adjudicators Office will consider an investigation. As part of any investigation the person may be asked to attend (or the person may request) a meeting to give further information or evidence. Adjudicator's Office enquiries may conclude by way of a recommendation letter (setting out what, if anything, HMRC should do to put the position right) or by way of mediation where the Adjudicator's Office will set out a resolution acceptable to the person and HMRC.

For more information on the Adjudicators Office website:

<http://www.adjudicatorsoffice.gov.uk/>

Find out about the HMRC Complaints procedure:

<http://www.hmrc.gov.uk/complaints-appeals/how-to-complain/index.htm>

### **What will happen to the charity if the person is not fit and proper?**

Where HMRC has found someone is not a fit and proper person then, as explained above, HMRC will advise the person of its decision and the person may ask for that decision to be reviewed by a senior manager in HMRC Charities, if necessary also by the Head of HMRC Charities and if necessary also by the Adjudicator. If after those reviews HMRC still considers the person is not fit and proper HMRC will ask them if they intend remaining as a manager of the charity. If the person stands down as a manager HMRC will not normally inform the charity; however, if they remain as a manager HMRC will notify the charity that it considers that the manager is not a fit and proper person. HMRC is not normally able to disclose specific concerns about the person to the charity without the person's permission but they will need to explain that, because the manager is not a fit and proper person, the management condition is not met and so tax relief may not be given.

HMRC will also, where appropriate, advise the charity what it must do, and by when, if HMRC is to apply its discretion to treat the charity as having met the management condition throughout the period of the person's term in office. For instance, the conditions may require the charity to move the manager from a particular role within a specified period or ensure that person has no access to, or control of, charity funds or put in place close supervision of the person's activities.

**A charity's tax reliefs and exemptions will not be withdrawn during an enquiry into whether it meets the management condition. HMRC may however decide not to make repayments of tax during an enquiry, depending on the circumstances.** Where the management condition is found to be satisfied, or HMRC treats the

management condition as being met, throughout the period then the charity will qualify for tax reliefs and exemptions throughout the period. HMRC will make any outstanding repayments at the conclusion of that enquiry.

If, in exceptional cases, the charity does not make any changes HMRC may reject the charity's claim to tax relief. The charity would have a right of appeal through the normal procedures, either by way of appealing against HMRC's refusal of the claim or against an amended assessment to tax, depending on whether the claim to relief was included in a return.

Find out more about how to appeal against a decision:  
<http://www.hmrc.gov.uk/complaints-appeals/index.htm>

### **What will HMRC tell charity regulators?**

HMRC works closely with the UK charity regulators and where HMRC identifies a manager who is not considered to be a fit and proper person HMRC will advise the relevant charity regulator of the concerns where permitted by law to disclose the information.

### **What should charities do to comply with the fit and proper persons test?**

HMRC assumes that trustees of a charity would not knowingly appoint someone who was not a fit and proper person. HMRC's general presumption is that all managers are fit and proper persons and HMRC will not routinely ask charities to demonstrate that their managers are fit and proper persons. As mentioned above, HMRC will exercise its discretion to treat a charity as meeting the management condition where managers who might not be considered to be fit and proper persons are not able to exert control over the charity's finances and tax affairs.

However, HMRC will expect charity trustees to be able to show, if asked, that they have given proper consideration to the suitability of people they appoint to positions of trust or influence in the charity, where they are able to exert control over the charity's finances and tax affairs.

It is up to charities to decide how they will be able to demonstrate that they have given proper consideration to the suitability of managers, and that the managers are fit and proper persons.

Some, but not all, charities will already have procedures in place, such as records of following up references for the person on their appointment. Charities may wish to devise their own procedures or, if they wish, they can follow the suggested procedure below.

### **Suggested procedure for charities when they appoint new managers**

There is no statutory requirement for charities to follow this suggested procedure but asking managers to read the basic guide and sign a declaration based on the model declaration included in the guide is one way the charity can demonstrate to HMRC that it has taken the necessary steps to reassure itself its managers are fit and proper.

Using the basic guide and model declaration in the way suggested will mean that a charity can assume that they meet the management condition at all times unless they knowingly appoint a manager who is not a fit and proper person to a position from which the person is able to influence the charitable purposes of the charity or the application of its funds or, exceptionally, they are challenged by HMRC:

- Charities should ask all newly appointed managers to read the basic guide and sign a declaration based on the model declaration. Bear in mind that, as explained above, the term 'manager' in this context means more than the everyday meaning of the word.
- Assuming the manager signs the declaration the charity should keep that declaration in case HMRC asks to see it. The declaration should be kept for the duration of the manager's engagement with the charity, and for four years after the manager has departed.
- If the new manager is to be one of the 'responsible persons' or the 'authorised official' as described below the charity will need to notify HMRC of their appointment on form ChV1.
- The charity can then assume they meet the management condition unless HMRC contacts them.
- If the manager refuses to sign the declaration (and refuses to comply with any other attempts by the charity to verify their suitability as a fit and proper person) then the charity should decide for themselves whether that person should be appointed as a manager of the charity and what financial responsibilities they should be given.
- If the person signs the declaration but adds information in the box the charity will need to consider that information and decide whether to seek advice from HMRC on what to do.

The Fit and Proper Persons test: a basic guide for managers of charities (<http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/model-dec-ff-persons.pdf>)

### **Which managers do charities need to tell HMRC about?**

As explained above the definition of 'managers' covers a potentially wide range of individuals. HMRC need to ensure that the managers making tax claims and receiving tax payments are authorised to do so by the charity and are fit and proper persons.

HMRC may ask a charity about any of its managers but, unless specifically asked to provide more details, charities should only tell HMRC when they appoint or change certain categories of managers:

- The Authorised Official – the authorised official is the person **within** your charity you have told HMRC is authorised to deal with your tax affairs, make Gift Aid or other repayment claims and, where necessary, sign and submit tax returns. This is the person HMRC will contact if they have any questions about your charity.

- The Responsible Persons- a responsible person will normally be a trustee or director of the charity (if the charity is a company), or a CASC official. You need to nominate a minimum of two, maximum of four, responsible persons.

Although nominees are not 'managers' for the purposes of the fit and proper persons test, you do still need to notify HMRC if you appoint a nominee or that nominee changes. A nominee is an individual or organisation **outside** your charity who you have authorised to submit Gift Aid or other repayment claims to HMRC on your behalf. They might just make the claims for your charity or they might make the claim and receive the repayment for your charity.

**HMRC will only act on information about changes to responsible persons, the authorised official and nominees (and agents – see below for more information on agents), and changes to the charity's details such as their address and bank account if the notification is made by existing responsible persons or authorised officials.**

#### **Charities with an existing HMRC charity reference**

Charities that already have an HMRC charity reference will not normally be asked to complete an 'HMRC Charity Application Form' (ChA1) to confirm their eligibility to charity tax reliefs.

They will not need to do anything **until** they need to notify changes in the charity's details, such as their address, or changes in the individuals who deal with HMRC on a day to day basis (authorised officials or nominees) or the charity's agent (see below for more details about agents).

On the first occasion that the charity needs to notify HMRC of such a change, it should use the 'HMRC Charities Variations Form' (ChV1) and should include details of the two to four responsible persons who, from that date, together with the authorised official, will be the only persons on whose authority HMRC will act to change details on the charity's tax record.

#### **Charities without an existing HMRC charity reference**

The first time a charity claims a tax relief or exemption HMRC may ask them to complete an 'HMRC Charity Application Form' (ChA1). The form ChA1 replaces the former procedure by which HMRC checked a charity's eligibility to charity tax reliefs and which was carried out through correspondence.

All charities claiming Gift Aid repayments of tax for the first time will be asked to complete an application form. If you are asked to complete a form ChA1 you will need to provide information about the responsible persons, authorised officials and nominees.

Once HMRC is content that a charity is entitled to claim tax reliefs and exemptions they will issue it with an HMRC Charities reference. This is a reference number starting two letters followed by some numbers such as AB123456.

## Telling HMRC about changes

HMRC asks all charities to let it know when **certain** managers change. Charities do **not** need to inform HMRC of **all** changes to managers.

Notification of changes should be made on the 'HMRC Charities Variations Form' (ChV1) which is also the form for charities to notify HMRC of certain other changes to their organisation. Form ChV1 replaces a number of old forms (ChN1, ChN2, ChN2A and part of form R68) used for notifying HMRC of changes in personnel.

Charities only need to inform HMRC when the following people change:

- the authorised official
- nominees
- agents
- responsible persons

You should use form ChV1 to notify HMRC about such changes – except agents as explained below. You do not have to tell HMRC about changes of other managers unless you wish to do so. If you do wish to do so then you should use page 6 on form ChV1 to explain what other managers have left and what new ones have arrived.

As mentioned above, a charity that has not already notified HMRC of the details of the responsible persons must also include details of the responsible persons on the first occasion they need to tell HMRC of a change to a manager. From that point the responsible persons or the authorised official will be the only persons on whose authority HMRC will act to change details on the charity's tax record.

## What about agents?

An agent is an individual or organisation **outside** your charity who acts on your behalf, such as an accountant or lawyer. You do not have to have an agent but if you do they can submit tax returns, prepare accounts or exchange information with HMRC on your behalf. There is a separate process for informing HMRC that you have appointed an agent using form 64-8. Form 64-8 is available on the HMRC website and you must send HMRC a completed form whenever you appoint a new agent. However there are three specific situations where, in addition to the 64-8 you will also need to send HMRC a completed 'HMRC Charities Variations Form' (ChV1) regarding an agent:

- If you appoint an agent as a nominee for your charity then you must tell HMRC. You must also tell HMRC if they cease to act as a nominee, again by using the 'HMRC Charities Variations Form' (ChV1).
- The only time it is possible for an agent to be the 'Authorised Official' is if the agent is already a 'manager' of your charity. This would normally apply where the agent is a trustee or director of the charity. If an agent is not already a 'manager' then they cannot be the authorised official for your charity. You need to tell HMRC when an agent is appointed as your authorised official, or when they cease to be, on the 'HMRC Charities Variations Form' (ChV1).
- If you appoint a new agent to your charity and you have not already told HMRC of the responsible persons in the charity then you should provide



those details on the 'HMRC Charities Variations Form' (ChV1). HMRC will only act on information about changes if the notification is made by a responsible person or authorised official.

**You should send your completed form 64-8 to HMRC Charities, Variations Team, St John's House, Merton Road, Liverpool, L75 1BB, not the address of the Central Agent Authorisation Team that is listed on the form.**

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