



Charity Briefing

Keeping you up to date with events in your sector.

Welcome

Welcome to this edition of Charity Briefing and I hope that you find the articles of interest to you.

We are all aware that we have been in a serious recession caused by the credit crunch and whilst there is some question as to whether or not we have emerged from it the importance of confidence is obvious. Confidence to spend is the key to future growth in all sectors of the economy. What is clear is that at present confidence is extremely fragile.

Our charities team includes specialists not only in charity audit and accounting but also tax, VAT, fraud and due diligence on acquisition and restructuring. In the current economic climate individuals, businesses and government bodies have found their cash resources squeezed and inevitably this has

had an impact on the fundraising activities of charities; this coupled with an increase in demand on the services that charities provide has resulted in a huge challenge for the sector over the last twelve months. We aim to ensure that the most tax and VAT efficient structures are in place thereby helping to maximise the cash position of our clients.

If as a result of these articles, you have any questions about our services, please contact myself or other members of our charity team. I look forward to seeing you at one of our upcoming charity seminars, for which details are available on our website.



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'Do look a gift horse in the mouth' Legacies: a cautionary tale

As solicitors working with charities in order to maximise their legacy income, we do come across some very interesting cases. The longest-running case I've worked on relates to a lady who died in 1989! That case acts as a textbook example for charities on how professional involvement (from the right professionals) can help to maximise legacy returns:

- The lady in question owned a significant landed estate, which she left in its entirety to be divided between a number of national charities.
- She appointed a tenant on her estate and others who had worked locally to act with her family as her executors.
- Probate was duly obtained by a local solicitor, and the estate as a whole was valued at approximately £3.4m.
- The executors proposed to sell off the landed estate as a whole, hoping to achieve something near to the probate value, with the exception of a particular farm that was to be sold to one of the executors as a sitting tenant.
- Before any sales were made, one of the charities in particular expressed interest in establishing the nature of the estate, and a specialist national land agent with a local office was instructed to do this.
- That land agent established that the landed estate would be worth significantly more if dealt with as individual lots and if tenanted lots could be retained so that a vacant possession value could be obtained.
- The charities instructed me to work with the land agent and they were able to stop the executors dealing with the estate as they had intended. All sorts of problems emerged from the woodwork on closer examination including, sadly, an unrelated issue with the local solicitor which did not lead to the estate losing any funds but which led to him spending some time 'at Her Majesty's Pleasure'. The executors retired and were replaced by three trustees (including myself) acting on behalf of the charities.
- 20 years later the estate has almost completely been sold off for the benefit of the charities except for one lot of potential development land which may yet produce a significant return for the charities.



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- There has of course been significant cost and administration involved in running matters during those 20 years but the total return produced for the charities has so far amounted to some £6.5m, with retained development land and funds totalling some £400,000. That represents a very considerable return above the probate value and has created a significant annual income stream for the charities.

Charities have of course become much more professional in their collection of legacies since this case commenced in 1991. However, there is a clear lesson to be drawn from this case, Charities should be careful not to always accept at face value what is offered to them from estates – **do** ‘look gift horses in the mouth’. Charities, especially in these uncertain times, need to ensure that they understand the nature and extent of their legacy entitlements. Suitable professional involvement can help to maximise returns and ensure that the generosity of donors is fully realised.

Website Monitor

Public benefit assessments

In a news release in July 2009, the Charity Commission is reminding all charities to show what makes them charities.

The requirement for all charities to demonstrate public benefit was introduced in the Charities Act 2006. In the latest phase of its work to raise awareness and understanding of the new requirement, the Charity Commission has published assessments of the public benefit of twelve charities. The charities assessed include some advancing religion, fee-charging residential care homes and fee-charging schools. Of the twelve assessed, eight are meeting the public benefit requirement and four are not currently meeting the requirement.

The Commission has also published its ‘Emerging Findings’ report with additional information for trustees about meeting the public benefit requirement. The report contains points of interest from the assessment process which will be of interest to all charities. The Charity Commission published

its general guidance for charities in January 2008, followed by supplementary guidance in December 2008, following extensive consultation. Example trustee annual reports are also available on the Commission’s website.

All twelve of the charities have already seen their reports and know whether they are currently meeting the public benefit requirement. The charities that are not currently meeting the requirement have three months in which to confirm that they have considered their assessment report and will put a plan in place to enable the charity to meet the public benefit requirement, and then a further nine months to submit a suitable plan to the Commission.

Copies of the assessments and the Emerging Findings report are available online from the Charity Commission website.

The release also includes answers to eight specific questions.



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Supporting charities in difficult times - Charity Commission publishes its Annual Report



The past year has been a difficult one for many charities, trying to meet the growing demand for their services while coping with falling income.

The Charity Commission has published its annual report for 2008/09, showing the work it has undertaken over the year to support the 190,000 charities registered in England and Wales.

As well as providing guidance and support to help charities work more effectively, the Commission’s focus has been on maintaining the high levels of trust and confidence which the public have in charities.

Key highlights of the Commission’s year include:

- opening over 33,000 individual advisory charity cases for charities with a combined total income of nearly £30 billion
- answering 210,000 calls from charities and the public via the contact centre
- answering over 52,000 letters and 50,000 emails from charity trustees and the public
- registering 5,410 new charities

- removing 7,433 inactive charities from the register
- making 1,860 legal schemes and orders for charities to change and modernise
- completing 188 investigations as part of their compliance work
- achieving a 60% increase in take-up of online services
- publishing supplementary public benefit guidance for charities whose aims include preventing or relieving poverty, advancing education and those which charge fees
- launching a new – widely acclaimed – version of the online Register of Charities.
- producing an ‘MP toolkit’ to raise awareness of the sector and the Commission’s role amongst Parliamentarians and Welsh Assembly members
- establishing an Advisory Group on faith.

The Annual Report also covers the work of The Faith and Social Cohesion Unit, International Programme and a range of new publications and reports.

The Charity Commission Annual Report 2008-09 is available from the Commission’s website.

Consultation on new charity investment proposals begins

A public consultation on new proposals to bring charity collective investments more fully under the regulation of the Financial Services Authority (FSA) has been launched. The proposals, which include creating a new collective investment product exclusively for charities to be regulated by the FSA, were announced in April's Budget statement and are the result of discussions between the Charity Commission, HM Treasury, HM Revenue and Customs, the Office of the Third Sector and the FSA.

Currently, collective investment schemes specifically for charities are usually Common Investment Funds (CIFs) or Common Deposit Funds (CDFs) which are created and regulated by the Commission.

Under the new proposals:

- charities would benefit from the protection of the FSA's existing authorised fund regime
- all charities would benefit from collective investment schemes being authorised and regulated by the FSA
- the current duplication of supervision and monitoring by the Charity Commission and the FSA would be ended.

Any new investment format included in the proposals would keep the same tax advantages currently enjoyed by CIFs and CDFs.

The consultation can be found at www.hm-treasury.gov.uk/consult_liveindex.htm and ran until 31 October 2009.

To grow or not to grow: M&A may be the answer

In these uncertain times, some charities are struggling to budget annual donorships. In years gone past, many charities could forecast their levels of donations and budget their expenses accordingly. Now more than ever, the budgeting exercise is increasingly complex. Trustees are looking to their finance committees for assistance in knowing what they can afford to spend whilst they look to restructure the activities of the charity. This change in focus has led to an increase in merger and acquisition (M&A) activity in the sector in a number of ways.

For example, two charities looking to provide similar services to the community in which they operate, although possibly in neighbouring counties, may now find themselves competing for donations. This scenario has led a number of charities to discuss mergers to enable them to continue to provide a full service to the communities but with reduced costs. By merging with a charity which has the same or similar purpose, the best operating techniques of both can be employed to the benefit of a wider community.

Other charities are also looking to private businesses which may be struggling. Where a charity may wish to provide additional services or products, they are looking at possibilities of acquiring trade and assets from the private business community.

Charities looking to embark on M&A similar to the examples above should consider the following common pitfalls before they proceed:

1. Poor strategic fit – always ensure a thorough review of the benefits which an acquisition or merger can bring to the charity. Overestimating financial benefits can have drastic consequences for charities' finances.
2. Poor cultural fit – this is an area which often makes mergers of charities difficult. Reviewing cultural fit early in the process is important in ensuring the process will succeed.
3. Carrying out limited due diligence – plan for and carry out thorough legal and financial due diligence to ensure you know exactly what you are buying or merging with.
4. Paying too much – this is a difficult issue for a charity, but can be avoided by structuring mergers or acquisitions based on the results of thorough due diligence. Linking

with points one (strategic fit) and three (due diligence) above can ensure the correct level of consideration is paid. Having a professional valuation of an acquiring business or charity undertaken could be considered to assist with this.

5. Not dedicating sufficient resource – M&A however small can take significant resources and a dedicated project team (that needs to include representation from the trustees, finance team and external advisors) is imperative.

For case studies of projects which Chantrey Vellacott has assisted charity clients with, please see <http://www.cvdfk.com/sectors/charities/>.

If you would like to discuss any acquisition or merger issues in connection with your own charity, please contact Debbie Clarke.



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VAT update

Penalties and VAT reviews

There is a new penalty regime for errors that occur in periods starting after 1 June 2009. You will now receive an automatic penalty of 30% for unconcealed errors – unless you can show that due care has been taken. This is a radical departure from the previous penalty regime, which only applied if the error was large relative to your turnover. The new rules apply potentially to errors of any size. For example, if you accidentally over recover £300 VAT and HMRC assess, you will receive a £90 penalty.

Another important change is that errors declared to HMRC (voluntary disclosures) are not automatically excluded from the regime, although HMRC have stated that penalties will rarely be applied.

The new penalty regime means you must ensure that you take care with your VAT. If there is an issue you are unsure about then clarify the matter. If you can show you have taken due care (for example by obtaining VAT advice from a VAT advisor) then HMRC have stated they will accept due care has been taken even if they disagree with the treatment. The fact you have an annual audit does not automatically mean you can be said to have taken due care.

When we undertake a VAT review, we provide a report that discusses all aspects of a client's VAT position, and explains why a particular treatment is appropriate. This will count as evidence of due care being taken and prevent future penalties. If you would like us to quote for such a review, contact the VAT team. If not, then we do recommend you document all your VAT decisions. Not only is a documented record stronger than verbal evidence, if HMRC challenge, but staff change and what may be obvious to you may not be so obvious to your successor.

Partial exemption changes

From 1 April 2009, HMRC introduced a number of partial exemption simplifications that may benefit charities.

You may recall that partial exemption is a VAT recovery calculation undertaken after an allowance has been made for non-business activities. It is usually done using an income method whereby the percentage of residual or overhead input VAT recoverable is determined by comparing taxable income to total income. The calculation is carried out quarterly with an annual adjustment calculation at the end of the VAT year.

The change that will be of particular use to charities is that you can now decide to use your annual adjustment percentage recovery to calculate your quarterly recovery until the next adjustment is due. This is a welcome simplification - particularly for charities that experience a fluctuating taxable turnover (for example, membership bodies which receive their subscriptions in the early part of the year).

Another change relates to VAT years and the annual adjustment. A VAT year runs to the end of the March, April or May quarters. Previously, the annual adjustment



was due in the quarter following the VAT year-end. This meant that if you had a March return, the adjustment would be due on your next return in June. Since 1 April you are now allowed to add the adjustment to the return for the VAT year end itself. This treatment is optional and if your annual adjustment results in your refunding VAT previously recovered, you may choose to delay until the next quarter.

Although HMRC consulted upon the subject, they chose not to change the rules governing the timing of VAT years. The law requires that these end in the March, April or May quarters unless HMRC has given permission for an alternative.

Mistakes are often made with the timing of VAT year ends. Charities frequently perform their annual adjustment in line with their financial year-end, which may well be incorrect. If you are in this position we would recommend you take steps to regularise your position by seeking HMRC agreement to a non standard VAT year. This is now particularly important under the new penalty regime discussed above.

Rate changes

The VAT rate reverts to 17.5% from Jan 1st 2010 and it seems quite likely that it will increase again following the next election. This creates a different set of issues to a rate fall.

When the VAT rate changes, you are allowed to use the time a service or good is supplied to determine the time of supply and thus the VAT rate applicable. This differs from the normal rules, which are concerned with the 'actual tax point' which is determined by the invoice or payment date. Since it is more normal to receive payment after work has taken place, this option is rarely used when rates fall. If you undertook work when the rate was 17.5% but issued an invoice after the reduction to 15% you would have the option to charge the higher rate of VAT but might have disgruntled customers!

When the VAT rate rises, the special rule is more useful as you can account for VAT at 15% on work undertaken before 1 Jan 2010 which is invoiced afterwards. You can also expect to receive VAT invoices at the lower rate from some of your suppliers for some time after the rate changes. In some cases, you will receive invoices that are apportioned between both rates and need to ensure your systems can cope with this.



We will be open for VAT rate change queries right up to the VAT rate change and will be delighted to advise you.

Loss of concessions

VAT rules are normally set by Parliament through Act or Regulation. However, there are exceptions to this where HMRC sets rules by means of Extra Statutory Concession (ESCs). These are generally introduced where legislation would be difficult – or in the case of VAT, possibly contrary to European VAT. They generally relieve rather than tax and are optional for the taxpayer.

In many ways ESCs are an unsatisfactory way of setting VAT rules as they are entirely within HMRC's gift, and disagreements in interpretation cannot be dealt with by the normal tax appeals structure. Instead judicial review is required, which for disputes over questions such as 'whether a bucket is a fundraising receptacle' for the purposes of the fundraising equipment concession, is not very practical. However, it is better to have the reliefs provided by ESCs than not. Sadly, they are now gradually being withdrawn.

The reason for withdrawal is a House of Lords judgment in a direct tax case where the Court concluded that ESCs were unacceptable and should be legislated for or removed. HMRC has been undertaking this exercise under a rolling programme, leaving the politically controversial ones until the end. Unfortunately we are getting nearer the end.

In July 2009, HMRC announced the withdrawal of ESC 3.29 from 1 July 2010. This allows charities to obtain zero rating on building and construction work. The zero rating was on the basis of their using it 'otherwise than in the course of business' - even though they have up to 10% business use. It also applies to the option to tax disapplication.

Replacing the ESC with legislation would require permission from the EU which would not be forthcoming. However, HMRC have attempted to reduce the impact of removing the ESC by means of a policy change. This takes the meaning of 'otherwise than in the course or furtherance of business' as being less than 5% business. They have also stated that charities can now use any reasonable method in calculating business use. This should mean that most organisations that benefited from the previous concession can obtain relief. It may also mean that some will now be able to benefit from relief for the first time.

The policy change is based on a non-VAT case that is a number of years old. If you have been refused relief under ESC 3.29 in the past and would have benefited from the new policy then it may be possible to reopen the matter, although HMRC are likely to resist the claim.

Unfortunately the withdrawal of ESC 3.29 will be followed in coming months by the likely loss of others. For example, the ESC on fundraising materials and acknowledgment tokens is likely to disappear.

Another ESC likely to be removed is the one that allows membership organisations to apportion their subscriptions between exempt and zero rated elements. The loss of this could annihilate VAT recovery for many membership charities, trade unions, political parties and learned societies. If you are a charity that uses this ESC then it may be worth considering the impact of its removal and if there is any alternative to your using the ESC.

VAT and business - the end of Lennartz?

The question of what constitutes a business activity for VAT purposes is one of the most problematic for the charity sector. This is because it is very subjective, and also because treating an activity as 'non-business' results in irrecoverable VAT. It has been further complicated by a seemingly inconsistent case law.

It is apparent that the business or non-business question would benefit from a clear, high-level court judgment, and it is possible that a recent ECJ case - VNLTO - may provide this. It is just unfortunate that this is likely to be at the cost of one of the most useful reliefs for UK charities - Lennartz.

If you incur VAT on expenditure you intend to use for both business and non-business purposes you can take two approaches. The most common is to apportion the VAT by means of a business/non-business apportionment and recover part. The alternative is to apply the Lennartz approach and recover all of the VAT up front and then pay back the non business part of the VAT over time – in some cases allowing for a substantial cash flow benefit.

Lennartz has been a battleground between HMRC and advisors for many years. This is not surprising as it is generally going to be more beneficial for charities than an initial apportionment, allowing them a cash flow benefit. With expensive purchases such as property this can be worth millions.

HMRC frequently attempted to restrict the application of Lennartz but were defeated in the courts and eventually accepted the inevitable and introduced regulations to cover its operation. These state that for buildings the payback adjustment must be made over ten years and other expenditure over five.

Unfortunately this status quo has been disturbed by a European Court (ECJ) case - VNLTO. This case was concerned with a Dutch farmers' collective and was referred to the ECJ to seek clarification about how to apply Lennartz - it being accepted on both sides that it could apply. Unfortunately the ECJ had very different ideas. The Dutch

farmers who undertook activities for no charge, which we would regard as non-business, had no private use of the assets in question and consequently could not use a Lennartz calculation. A distinction was drawn between private and non-business use.

One of the problems with the ECJ is that there is no appeal - which means that when the court does decide to depart from all the arguments put to it and adopt its own reasoning, it can set in stone an approach which has never been argued in a national court or adequately considered by member states or the EU commission.

HMRC are still considering the ECJ judgment, but clearly will have to act as it does appear to indicate that current

UK practice is wrong. It appears almost inevitable that they will conclude new Lennartz schemes must stop, although existing schemes are unlikely to be disturbed.

Quite how HMRC will change UK law remains to be seen, as the concept of business is fundamental to the operation of the VAT system – and it is hard to see how a distinction can be drawn between ‘private non-business’ and other ‘non-business’ without a major legislation rewrite. However, a redefinition of ‘non-business’ may bring welcome clarity to the confused question of what business means for VAT purposes, albeit at the cost of a useful relief.

Please contact Peter Ladanyi if you would like to discuss any of the above matters.

Payment Card Industry Data Security Standard

The PCI DSS is a compliance standard that has been developed in order to help organisations proactively reduce the risk of data compromise and the effects of fraud.

Organisations processing credit cards that failed to meet the October 1, 2009 deadline (to become PCI DSS compliant) face mounting pressure as failure to comply or a system compromise that causes customer card details to be used fraudulently may result in a financial penalty or termination of processing services.

The standard contains 12 requirements for implementing effective information and data security practices. These requirements cover technical aspects of security management, and also impact policies and procedures.

Organisations affected by the PCI DSS include all acquiring banks, all merchants that accept payment cards, and all service

providers who store or transmit card or transaction data.

In order to achieve compliance organisations must ensure their systems, and those of any third parties they work with, meet the 12 requirements of the PCI DSS. They must then conduct an audit, which is usually carried out by a Qualified Security Assessor (QSA). Compliance must be maintained on an ongoing basis.

As the evolution towards a cashless society continues to gain pace, compliance with the PCI DSS is becoming ever-more essential. Are you ready?



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