CHARITIES ROUND-UP

Rollits' charities team provide the lowdown on the status, structure and pension obligations of charitable organisations

Charitable Incorporated Organisations

- Phased timetable for existing charities to incorporate as or convert to CIOs.
- CIO structure has benefits of an incorporated structure, but avoids dual regulation.

The Charitable Incorporated Organisation (CIO) structure became available to new charities from 3 January 2013. It is the first incorporated structure designed specifically for charities.

The Charity Commission (the commission) confirmed in March this year that it had registered 56 CIOs since registration began in January. Neil Robertson, the commission's head of operations in Taunton, also confirmed that many applications had been made by small and medium sized organisations.

There is a phased introduction for existing unincorporated charities to incorporate as CIOs and, since the end of March, existing unincorporated charities with income of over £250,000, have been able to set up a CIO and transfer its assets into it. This will be extended to:

- existing unincorporated charities with incomes between £100,000 and £250,000 from 1 May 2013;
- existing unincorporated charities with incomes between £25,000 and £100,000 from 1 July 2013;
- existing unincorporated charities with annual incomes of between £5,000 and £25,000 from autumn 2013; and
- existing unincorporated charities with annual incomes of less than £5,000 from the beginning of 2014.

It is anticipated that during 2014 existing incorporated charities will be able to convert to the CIO structure, but the enabling legal framework will first need to be brought into force and this may also be introduced on a phased basis. Existing charities will not be forced to convert to the CIO structure, but some might wish to do so.

The CIO may be a more attractive legal framework for smaller to medium sized charities which want to operate through an incorporated structure and have limited liability. Many incorporated charities are companies limited by guarantee and are therefore regulated by both the commission and Companies House and charity law and company law. Being regulated solely by the commission and charity law will hopefully simplify registration and regulation and save costs.

However, the CIO structure may not be suitable for larger charities which raise finance by secured borrowing. The commission is not currently required to keep the equivalent of Companies House's Register of Mortgages, which might put off traditional lenders who would want equivalent protection of registration of their security interest over the CIO's assets at the commission. The commission has acknowledged that a lot of larger charities are likely to continue to use the company structure for the time being because it is tried and tested and understood by third parties and funders.

Furthermore, as CIOs are a new form of legal entity, there is still some uncertainty as to how this new structure will evolve. It is untried and untested and it may be some time before we fully see how it will operate in practice. It is possibly too early to comment on the success of the new structure; however, in the long term, this unique structure designed exclusively for charities, may evolve and become the most favoured charity structure for charities in England and Wales, as has been reported from Scotland where the Scottish CIO has been available for some time.

The Preston Down Trust

- The Charity Commission's decision to refuse registered charitable status to the trust may have wider implications for religious and faith-based organisations.
- Tribunal proceedings have been stayed while discussions take place to try and resolve this issue in a less costly way.

Following the controversial decision by the commission to refuse to register the Preston Down Trust (of the Plymouth Brethren Church) with charitable status, there has been a pause on the appeal proceedings to allow the trust and the commission to explore an alternative resolution than tribunal proceedings.

The commission's reasoning for refusing the trust's application for charity status included having concerns about the lack of public access to participation in religious services including Holy Communion. In a February statement, the commission said that any application for registration must set out exclusively charitable purposes and explain how these will be advanced for the public benefit.

The Charities Act 2006 removed the presumption that a charity set up to advance religion, education or to relieve poverty provided public benefit. All charities now have to actively demonstrate that their aims are for the public benefit.

The decision by the commission to refuse registered charitable status to the trust may have wider implications for religious and faith-based organisations, which may restrict participation in certain aspects of their services to those who are worshippers of their religion only. The decision by the commission has been heavily criticised for being too literal in its interpretation of the public benefit requirement. Some commentators have also said that the commission is seeking to interfere in the practice of religious rituals.

The trust appealed against the commission's decision and the appeal hearing was fixed to take place in late March this year, however the commission granted the trust's request to stay proceedings while discussions take place to try and resolve this issue in a less costly way.

The commission has confirmed that if it is not possible to deal with the issue in this way, then the trust will not be registered and the trustees will have the option of lifting the stay of legal proceedings and continuing with the tribunal process.

The commission has also emphasised that it will continue to ensure it is ready to take part in any such proceedings.

Because of the wide implications that the decision has, many charities which are for the purposes of advancement of religion will be keeping a watchful eye on this case and how it progresses.

It will be interesting to see the outcome of any appeal and whether it has any implications for other religious or faith based organisations hoping to obtain registered charitable status.

Pension deficit risk

- Charities that have either set up defined benefit schemes or joined schemes such as the Local Government Pension Scheme or the SHPS may find that they have relatively large pension liabilities that they will ultimately be responsible for.
- Further insolvencies among charities may be expected due to the weight of their pensions liabilities, but charities can take positive action to lessen their deficits.

A number of charities have recently been in the news following their closure due to their inability to deal with rising pension deficits, and these highlight the risks charities face from pensions obligations.

One such charity is People Can, a Liverpool-based charity that helps the homeless and domestic abuse victims. The charity is a participating member in the Social Housing Pension Scheme (SHPS), a defined benefit scheme that it joined when it was a registered social landlord. The charity's pension deficit was revalued by the Pensions Trust, which administers the SHPS, from £11m earlier in the year to £17m by the time it went into administration in November 2012.

The Pensions Trust felt the charity was insufficiently resourced, and it would require payment of the whole of the £17m debt. The charity had insufficient assets to enable the debt to be repaid, even though it stated that it could meet its on-going pension contributions.

Charities like People Can, that have either set up defined benefit schemes or joined schemes such as the Local Government Pension Scheme or the SHPS as a response to taking on public sector workers in outsourced contracts that meet government's best-value requirements, may find they have relatively large pension liabilities that they will ultimately be responsible for.

This may include contributions at levels that may be hard to sustain, particularly if those levels are increased in response to increasing scheme deficits, as many charities run on tight margins and struggle to obtain funding to ease cash-flow pressures. This will particularly be the case where the pension scheme is large relative to the size of the charity.

The existence of large pension scheme deficits may also inhibit plans for charities to merge, as a merger normally results in the cessation of one charity, which could trigger a cessation debt – which means the charity must make up the entire deficit immediately. Alternatively, it could discourage the continuing charity from taking over such a significant deficit.

Observers have warned that further insolvencies among charities may be expected due to the weight of their pensions liabilities. In fact, the Pensions Trust has issued a warning to some of its "higher risk" members that they may not have enough assets to cover their liabilities, and have suggested that these organisations switch their staff out of their defined benefit schemes to defined contribution schemes.

Charities can take other positive action to lessen their deficits by paying more money into the scheme if possible or make payments for longer, as relying on investment returns remains risky, but the position remains difficult for many organisations.

If that weren't enough bad news, the government's plans to introduce a single-tier state pension a year earlier than expected, in 2016, will likely lead to an increase in pension costs of around 10% for many charities. This is because many charities currently belong to defined benefit schemes that are "contracted-out" of the state pension scheme, entitling them to a rebate on National Insurance contributions. Contracting-out will be scrapped with the introduction of the single-tier state pension resulting in an increased cost of pensions.

Private sector schemes will be allowed to amend their scheme rules to adjust future benefits or to increase employee contributions to offset the additional cost to employers. However, the government has previously guaranteed the provisions of the newly reformed public service pension schemes for 25 years, so no changes will be possible to these schemes. As many charities will have taken on government staff as part of a contract, they will be participants in public sector schemes and therefore will be hit by this extra cost.

Charities should ensure that they are aware of the potential risks and seek advice in terms of mitigating these.

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