

MEMORANDUM BY THE WELLCOME TRUST

Response to the Joint Committee on the draft Charities Bill

1 Summary

1.1 The Wellcome Trust (**the “Trust”**) is pleased to respond to the Joint Committee’s inquiry on the draft Charities Bill. We have focused our comments on the main areas identified in the Committee’s call for evidence. We have also highlighted a number of additional issues that, whilst not dealt with in the Bill, warrant changes in legislation in order to enhance the contribution that charities make to the general public good.

Exempt charities

1.2 The Trust is particularly concerned about the provisions in the Bill relating to the regulation of exempt charities and the potential impact of these proposals on universities, one of the Trust’s main funding constituencies. The Trust believes that exempt charities should ideally fall under the same main regulator as registered charities (i.e. the Charity Commission), rather than under a number of different regulators, as currently proposed. Having separate regulators is likely to complicate regulation and confuse the development of charity law.

1.3 However, with particular regard to universities, the Trust has concerns that the Charity Commission, as it currently interprets public benefit, may not accommodate in a sufficiently flexible manner the full range of work undertaken by such institutions - in particular, some of their ‘third stream’ activities involving interactions with business. The Trust believes that the Charity Commission should ensure that its position on these activities would make the Charity Commission a more viable regulatory option for universities whilst at the same time enabling *all* charities to benefit from the more flexible regulatory environment that would result. Further information can be found in Section 4 of our response (paragraphs 4.1 to 4.9).

Social and Economic Impact Objective

1.4 The Trust believes that the proposed social and economic impact objective for the Charity Commission takes the role for the Commission beyond that of regulator and should be removed from the Bill. Further information can be found in Paragraph 4.10.

The 12 charitable purposes

1.5 The Trust believes that the 12 new charitable purposes are satisfactory and agrees that leaving the public benefit test undefined in the Bill will enable it to stay up-to-date. Further information can be found in Section 6.

Setting-up trading subsidiaries

1.6 The Trust believes that the Government needs to make it easier for charities to set up trading subsidiaries. Further information can be found in Section 7.

Charitable Incorporated Organisation

- 1.7 The Trust supports the creation of a new corporate legal form, the Charitable Incorporated Organisation, but would like to emphasise that this should not become a mandatory form to be used by all charities. The Trust believes that a number of other considerations should be taken into account with regard to the detailed provisions for this new corporate entity (see Section 9).

Fiscal issues

- 1.8 The Trust considers that there are a number of fiscal issues that, whilst excluded from the scope of the Strategy Unit's Review and the Bill, must be addressed in order for the not-for-profit sector to achieve its full potential. These are outlined in Section 10.

2 About the Wellcome Trust

- 2.1 The Wellcome Trust is an independent, biomedical-research-funding charity (registered charity no. 210183) established under the will of Sir Henry Wellcome in 1936. Its mission is to foster and promote research with the aim of improving human and animal health.
- 2.2 The Trust is a privately endowed charity and does not raise any of its funds from the public. It has a diversified asset base of £10.1 billion (as at 30 September 2003). Its investments are managed both to provide an income to support the Trust's current and planned activities and to ensure long-term growth of the endowment.
- 2.3 The Trust is one of the largest non-governmental funders of biomedical research in the world. In the financial year ended 30 September 2003, the Trust's expenditure was more than £550 million, the majority of which was to fund research in the UK. The Trust's broad mission allows a very diverse portfolio of activities to be undertaken.

3 The Trust's input leading up to the Bill

- 3.1 The Trust has made two submissions to the Strategy Unit in relation to its review of charity law and regulation leading up to the Bill - the first in December 2001 before *Private Action, Public Benefit* was published by the Strategy Unit and the second in December 2002 in response to the consultation on the Strategy Unit's report. A copy of the Trust's second submission is attached at Appendix 1 to this Memorandum for the Committee's information.

4 Does the draft Bill strike the right balance between flexibility and accountability? How can the danger of over-regulation be avoided?

- 4.1 The Trust strongly endorses the principle that all organisations enjoying the advantages of charitable status should, in return for those advantages, comply with the basic principles of charity law. The Trust therefore welcomes section 11(3) of the Bill to increase compliance by the charity trustees of exempt charities with their legal obligations in exercising control and management of the administration of the charity.
- 4.2 However, the Trust has some reservations about the provisions in the Bill relating to who will act as the regulator of exempt charities, and in particular the potential impact of these proposals on universities, one of the Trust's main funding constituencies.
- 4.3 The Bill proposes that these charities have a principal regulator to monitor their compliance with charity law, although in many cases this will not be the Charity Commission. The Trust believes it is desirable for all charities to be subject to the same legal and regulatory framework and that ideally they would fall under the same regulator – the Charity Commission. Having an overarching regulator is important for maintaining public confidence as the public needs to have a clear understanding of where it can access information, who is accountable and how they can make a complaint. The fact that the Charity Commission already has within its remit charities as large and complex as the Trust and the National Trust, for example, means that the Charity Commission could develop to monitor, flexibly and intelligently, exempt charities such as universities.
- 4.4 Moreover, the Trust has concerns that some of the alternative regulators proposed – for example the Higher Education Funding Council for England acting as the principal regulator for universities – could pose potential conflicts of interest, as they are also the primary sources of funding for these institutions.
- 4.5 However, the Trust believes that the Charity Commission, as it currently operates, could be too restrictive a regulator of some activities currently undertaken by universities. Universities in the UK have been expected by their funding councils to ensure that the research results of universities are translated, in collaboration with industry, into tangible, practical outcomes that benefit the UK's economy. Such translation activities, when undertaken by universities, have always been considered by Government to be for the public benefit. However, charities registered with the Charity Commission which fund research undertaken by universities (such as the Trust) have not been treated equally with universities with regard to translation activities.
- 4.6 For example, where the Trust has in the past wished to fund certain non-research costs, such as funding the development of a business plan for a biomedical start-up company, the Charity Commission did not consider this to be for the public benefit (whereas the same activity in the hands of a university would be considered to be for the public benefit).
- 4.7 It appears that the discrepancy in treatment between registered charities and exempt charities in the field of translation may be lessening, particularly

following the Charity Commission's publication on Social Investments, which allows a registered charity to use its charitable funds to fund a start-up company provided that company's objectives are in line with the charity's objects.

- 4.8 However, to make the Charity Commission a viable regulatory option for universities, the Charity Commission needs to acknowledge expressly that funding for translation activities would be for the public benefit and would therefore be a charitable activity. The problems that have arisen as a result of these discrepancies are explained in more detail in paragraphs 40 to 54 of the Trust's submission to the Strategy Unit attached at Appendix 1. The Trust would urge that a better solution would be for the Charity Commission to develop a more flexible regime accommodating the needs of these activities and allowing *all* charities to be regulated more flexibly.
- 4.9 If the universities are not subject to the same regulator as the major charities that fund them, charity law, regulation and practice will continue to diverge, leading to confusion and inefficiencies. We believe that it will be vital for Scottish law to be harmonious with these aims for the same reason. We understand that the charity regulator of universities in Scotland will be the Office of the Scottish Charity Regulator (OSCR) and, if this is the case, this would be another argument for universities in England and Wales to be regulated by the Charity Commission so that the regulation of universities in the UK and their charity funders is consistent.
- 4.10 Generally, the Trust believes that the Bill strikes the right balance between flexibility and accountability and welcomes the measures to improve accountability and transparency across the charity sector and to assess performance improvement. However, the Trust does have some concerns about the "social and economic impact objective" for the Charity Commission set out at Section 5(2) of the Bill, which is intended to "enable and encourage charities to maximise their social and economic objective". This objective appears to take the Charity Commission's role beyond that of regulator and could be seen as a licence for the Commission to interfere in a charity's activities. The Trust believes that this objective should be removed from the Bill.

5 Will the Bill improve public confidence in charities?

With regard to improving public confidence, see our comments about the regulation of exempt charities at Section 4 of this Memorandum.

6 Are the 12 new charitable purposes the draft Bill proposes for a charity satisfactory - should there be additions or deletions? Is the phrase 'public benefit' best left undefined in the Bill?

- 6.1 The Trust believes that the 12 new charitable purposes are satisfactory and, in particular, welcomes the inclusion of the advancement of science as an express charitable purpose.
- 6.2 The Trust agrees that leaving the public benefit test undefined allows for the test to be flexible and to remain up-to-date. The Trust is of the view that the primary

responsibility for determining whether a charity is acting for public benefit must remain with the charity trustees.

7 Is it right that the draft Bill does not include the recommendation in the Strategy Unit consultation paper, Private Action, Public Benefit, that charities should be allowed to trade as part of their normal activities without the need to set up a trading company?

- 7.1 Yes. However, in the Trust's experience, setting up a trading subsidiary raises many difficult charity, tax, business rates, VAT and administrative issues, which have required significant resources to resolve. Therefore, the Government needs to make it easier for charities to set up trading subsidiaries.
- 7.2 One of the ways in which the Government can help charities in this regard would be to make the means of funding a trading subsidiary more flexible.
- 7.3 The Charity Commission strongly recommends that a trading subsidiary be funded by a charity by way of loan because it perceives a charity subscribing for equity in the trading subsidiary as being more risky (as shareholders are less likely to be paid than creditors). However, the loan route remains problematic for charities. Charities are generally prohibited from providing security for a loan by a commercial third party, such as a bank, to the trading subsidiary and the trading subsidiary itself will have no assets to use as security.
- 7.4 Furthermore, because the Charity Commission requires that a loan be made by the charity on market terms, the trading subsidiary would be required to make capital repayments and interest payments to the charity. Where the trading subsidiary is to gift aid all of its profits to the charity, the trading subsidiary would not be able to fund the loan repayments using its profits. Therefore the trading subsidiary would need to have funding indefinitely. The trading subsidiary could retain some of its profits to repay the loan but those profits would incur a tax liability.
- 7.5 The Trust believes that the Charity Commission should recognise (as Inland Revenue has) that charities may subscribe for equity, as an alternative to making a loan to its trading subsidiary, provided the trading subsidiary's business plan demonstrates that the charity's investment is a sound one.
- 7.6 The Trust also has concerns that certain transactions between a charity and its trading subsidiary may be caught by the new transfer pricing regulations that were introduced in April this year. HM Treasury has recently provided comfort that a charity itself will not be caught by the regulations where it is acting in pursuit of its charitable objects. However, a charity's trading subsidiary is caught by the regulations (as indeed will be some charity activities that are nevertheless exempt from tax, for example, renting property to a subsidiary company). The Trust believes that a wholly-owned trading subsidiary that intends to gift aid all of its profits back to the charity ought not to be caught. The Trust will be working with the Charities Tax Reform Group to continue a dialogue with Government on this issue.

8 Are the proposals to regulate fund-raising workable?

Because the Trust does not conduct any fund-raising, it has no comments on these.

9 Are the specific proposals in the draft Bill (such as the new corporate legal form, the Charitable Incorporated Organisation) adequate, workable and beneficial?

9.1 The Trust believes that the proposals in the Bill are adequate, workable and are likely to be beneficial to the sector. However, the Trust would like to emphasise that the use of a Charitable Incorporated Organisation (“CIO”) should remain an option and should not become a mandatory form to be used by all charities.

9.2 Directors of CIOs funding biomedical research involving the use of animals should be permitted to keep home addresses and other personal details of directors out of the public domain to protect them from animal rights extremists (as is currently possible for directors of companies who have successfully applied to Companies House for confidentiality orders in respect of these details).

9.3 It will be important to ensure that (i) the CIO would be eligible under VAT legislation for group relief with subsidiaries, (ii) the benefits of best principles of corporate governance for companies can be adopted by the boards of CIOs, and (iii) directors of CIOs have the same protections from personal liability as are available to the directors of existing companies.

10 Other matters upon which the Trust wishes to comment

Fiscal issues

10.1 A number of fiscal issues of key importance to the charity sector were excluded from the Strategy Unit’s Review. These are issues that require collaborative work across Government to ensure that the not-for-profit sector achieves its full potential. The fiscal issues of key importance are:

- (a) *Loss of Advance Corporation Tax credit relief.* The Trust has estimated that the financial impact on the Trust has been approximately £40 million *per annum*, since the decision to abolish the relief in 1999. Some progress has been made with HM Treasury and the Inland Revenue to find a method to compensate charities for this loss and we hope that the Government will treat this matter as a priority.
- (b) *Irrecoverable VAT.* In the Trust’s 2002/2003 financial year, the Trust estimated that it was unable to reclaim over £5.4 million of VAT incurred in providing exempt activities or activities outside the scope of VAT. HM Treasury uses a mechanism to protect local authorities from the unfair effects of VAT and a similar mechanism could be applied to charities so they would be able to reclaim their irrecoverable VAT. The VAT refunded could then be used by the charities to fulfil their charitable objects for the public benefit. If such a mechanism were introduced, this would also significantly lower the costs of charities administering VAT.

- (c) *Capital allowances on research and development relief.* The Trust is unable to benefit from the research and development tax credit incentives introduced by the Finance Act 2000 for small businesses and the Finance Act 2002 for large companies. The Trust believes that charitable funding bodies ought to be eligible for analogous incentives and that the rules should be made less restrictive.
- (d) *Tax treatment of charities undertaking trading activities.* See Section 7.6 of this Memorandum.
- (e) *The need to modernise sections 505 and 506 tax exemptions and Schedule 20 of the Income and Corporation Taxes Act 1988 (ICTA).* The drafting and operation in practice of these sections of ICTA are extremely complex. Simplification of these in the context of the overall improvements in charity law and regulation recommended by the Strategy Unit's Review would be very helpful for the sector. In particular, those sections need to reflect the total return portfolio theory, the new discretion for trustees over investments in the Trustee Act 2000 and the treatment of social investments.

Wellcome Trust
28 June 2004

Appendix 1

**Wellcome Trust Response to the consultation document:
*'Private Action, Public Benefit:
A Review of Charities and the Wider Not-For-Profit Sector'*
From the Strategy Unit of the Cabinet Office**

WELLCOME TRUST

1. The Wellcome Trust (“**Wellcome**”) is an independent, biomedical-research-funding charity (registered charity no. 210183) established under the will of Sir Henry Wellcome in 1936. Its mission is to foster and promote research with the aim of improving human and animal health. Its operations are international in nature.
2. There are two main factors that distinguish Wellcome from the vast majority of other charitable and voluntary organisations in the UK, both of which should be borne in mind when reading this submission. These are its:
 - ***Endowed charity status.*** Wellcome is a privately endowed charity and does not raise any of its funds from the public. It has a diversified asset base of some £9.4 billion (as at 30 September 2002). Its investments are managed both to provide an income to support Wellcome’s current and planned activities and to ensure long-term growth of the endowment.
 - ***Size and complexity.*** Wellcome is the largest non-Governmental funder of biomedical research in the world. In the financial year ended 30 September 2002, Wellcome’s expenditure was more than £550 million, the majority of which was in the UK. Wellcome’s broad mission of fostering “research with the aim of improving human and animal health” allows a diverse portfolio of activities to be undertaken.
3. The size of Wellcome’s endowment and breadth of activity means that it is a very complex organisation. Whilst we are broadly supportive of the aims of the Strategy Unit review (the “**Review**”), we are concerned that some of the legislation and regulations proposed within it may not be suitable for an organisation with this size, complexity and legacy. Furthermore, the legislation and regulations may be administratively burdensome, and may restrict our activities and our potential to meet our charitable objects. We believe that very large charities whose activities are transparent should be given greater flexibility, through a lighter regulatory regime, as to how they organise themselves and carry out their charitable aims and objectives. We are much more restricted, in a variety of ways, than many exempt organisations not regulated by the Charity Commission (e.g. universities) and yet our scope, size and purpose are at least comparable.

STRUCTURE OF RESPONSE

4. It has been made clear by the Strategy Unit that a number of issues fall outside the Review. Wellcome believes that many of these issues, for example VAT regulations, are of greater importance to charities than some of the matters tackled in the Review. We believe that HM Government, including the Home Office, HM Treasury and the

Department of Trade and Industry, must consider the impact of the Review's recommendations alongside all other legislation and regulation currently being developed or implemented across government, giving a fully integrated approach to the future treatment of charities.

5. To accommodate Wellcome's views on the detail of the Review's recommendation and our other issues of concern, our submission is ordered into three parts and an annex, as follows:

Part A. Wellcome's position on the Review's 61 recommendations;

Part B. Wellcome's views on additional issues raised by the Review that were not directly referred to in its recommendations;

Part C. Wellcome's comment on issues of concern that, although outside the scope of the review, we believe should be considered, giving the fully integrated approach needed to achieve HMG's vision for this sector.

Annex 1. A list of the Review's recommendations and where to find Wellcome's response in Parts A, B and C of this document.

PART A. THE REVIEW'S RECOMMENDATIONS

'HEADS' OF CHARITABLE PURPOSE

[Recommendation 1. That charity be redefined in law, based on the principle of public benefit and falling under one of ten new purposes of charity.]

6. Wellcome supports the Review's opinion that the current classification of charitable purposes into four "heads" is insufficient to reflect the range of objects that can be charitable. Under current law, research is included under the head of "advancement of education" and medical research is also included under the fourth head as "advancement of health".
7. However, we believe the new classification system fails to support explicitly a key activity of the medical research charities: research, which includes not only basic or fundamental research, but also strategic and applied research. The research process is complex, with much biomedical research being basic in nature and undertaken to increase the knowledge base and our understanding of biological processes or structures.
8. It could therefore be said that it was not directly included under the proposed second purpose (*'the advancement of education'*) or the proposed fourth purpose (*'the advancement of health'*). This research does however form the foundation from which advances in health can be made.
9. We therefore believe there is room for an additional purpose *'the advancement of research'*. This would make it clear that research has a public benefit, no matter how fundamental.
10. We also support the Charity Commission's recommendation that *'the new purposes will need to be further defined in statute'* and ask that it be explicitly stated that research is of public benefit.
11. In addition, given the critical importance to society of a scientifically literate population, we recommend that "science" be added to the sixth head, to read as follows: *'the advancement of culture, arts, heritage **and science'***.
12. We understand that there is some feeling in the voluntary sector that *'the promotion of animal welfare'* should be a separate purpose. Wellcome would have no objection to this, as long as it would not have any effect on the ability of scientists to use animals in research where necessary and appropriate.

TRADING

[Recommendation 3. To amend charity law to allow charities to undertake all trading within the charity, without the need for a trading company. The power to undertake trade would be subject to a specific statutory duty of care.]

13. *Support for charities to undertake all trading without the need for trading companies.*
We are broadly supportive of the recommendation that charities should be allowed to undertake all trading within the charity without the need for a trading company. In our experience, we have found that the charity-commercial company interface raises several

charity law, tax, VAT and administrative issues, which have been expensive and complex to resolve.

14. *Comments on statutory duty of care.* However, we have some specific comments on the duties proposed to form part of the new statutory duty of care, as follows:
- (a) A duty to give proper consideration to the need to structure the trade in a way which does not expose the assets of the charity to significant risk. It is well established that ring-fencing commercial activities in a trading subsidiary helps to isolate its parent company from risk. Risk can take various forms, e.g. legal, financial, or reputational, and in some cases this may not be quantifiable. The trustees of a charity wishing to trade must determine what risks are significant and what risks are acceptable. In order to promote consistency throughout the sector, it would therefore be helpful if guidance could be issued on the considerations that should be taken into account to help make this determination.
 - (b) A duty to take proper (professional) advice in connection with the establishment, exercise and discontinuance of the trade. We agree that prudent trustees should always take proper advice in connection with their charity's trading activities. However, a charity should be free to seek such professional advice from its pool of relevant in-house expertise, if available, and not just from independent professional advisers.
 - (c) A duty to consider the suitability to the charity of trading as a form of income generation, and to consider the suitability for that purpose of the particular trade or proposed trade. A duty to compare the economic benefits of the trade or proposed trade with other forms of income generation open to the charity. We are concerned that these two duties confuse charitable and investment motives. A charity may trade in order to fulfil its primary charitable purposes. It is therefore not appropriate to assess the suitability of a trade purely in terms of its ability to achieve a certain level of income generation. These new duties are not compatible with primary purpose trading, nor are they compatible with the Charity Commission's recent publication on "social investment" (previously called "programme-related investment"). We therefore suggest that these two duties are either (i) subject to the proviso that they only apply where the trading does not form part of the charity's primary charitable purpose (this would be our preferred solution), or (ii) replaced by a single duty to consider the suitability to the charity of trading.
15. *Ensuring tax neutrality where no trading company is used.* One of the significant benefits of using a trading company is that income excluded from charity tax exemptions can be earned by the subsidiary and gift-aided to its parent charity free of tax each year (with a wholly-owned subsidiary having nine months after the end of its financial year to make the payment effective in that year). For charities that decide to pursue trading activities without using a subsidiary vehicle, it will be necessary to change tax legislation in order to preserve this tax neutrality. In particular, changes will need to be made to section 505 of the Income, Corporation and Taxes Act 1988

(“ICTA 1988”), to ensure that income arising under Schedule D Cases I, II and VI¹ are also granted charitable tax exemptions, as these cover income that may be earned by a charity as a result of its trading and other activities.

16. *Use of subsidiaries not to be penalised.* Notwithstanding the above, it is clear that charities should have the option to continue to use subsidiaries for reasons other than tax, such as risk mitigation. In fact it is fair to say that where risk is a major issue for the charity, there is currently no other alternative. Therefore, any new legislation should not prevent this prudent use of trading subsidiaries from continuing under the same regulations and procedures as currently. Care should be taken to ensure that any subsidiaries that are used are not disadvantaged either directly or indirectly. For example, the fiscal advantages of using a subsidiary under current tax legislation should continue to be available.
17. *VAT considerations.* If charities are to be able to take full advantage of the recommendation, then HM Customs & Excise will need to provide a concession from the rules on zero rating of the construction of buildings to exclude trading by charities that complies with these new duties from the “business” use of the buildings.

NEW REPORTING REQUIREMENTS

[Recommendation 18. As part of their Report and Accounts, the largest charities should complete an annual Standard Information Return. This should highlight key qualitative and quantitative information about the charity, focusing on how it sets objectives and measures its outcomes against these.

Recommendation 19. The next charity SORP should develop improved methods for apportioning costs and expenditure, enabling more meaningful financial comparisons between organisations to be made.

Recommendation 20. Improvements should continue to be made to the SORP to strengthen its focus on achievements against objectives, organisational impact and future strategy.

Recommendation 31. That Government provides support to the sector for work on performance improvement as part of its wider commitment to build the sector’s capacity. The sector should work collectively to bring forward proposals by April 2003.

Recommendation 32. Specific sub-sectors (groups of organisations involved in the same area of service provision) should pilot test an approach to developing common performance indicators and benchmarking for the organisations in their area. If this were to prove successful, it could be used to encourage other sub-sectoral groupings to follow similar approaches. It is not proposed that the Government or the Charity Commission would have a role in the exercise.

Recommendation 34. The SORP should provide for annual reports to include a statement of procedures for recruitment, induction and training of new trustees.]

18. Any recommendation to improve accountability and transparency and to measure performance improvement across the sector is welcomed. It is however ultimately the role of the charity trustees to ensure that the public is provided with adequate and meaningful information. Whilst a standard return may be preferable to ease comparison, there is a need to avoid duplication of unnecessary effort as most of the information may currently be available elsewhere.

¹ Charities are already exempt from tax on income arising under Cases III, IV and V; Cases I, II cover income received from trading, professional/vocational activities. In addition to any other income not specifically taxed elsewhere, Case VI will also tax income caught by anti-avoidance legislation intended for tax payers rather than charities, e.g. Section 776 ICTA 1988.

19. The proposed two-page Standard Information Return (“**SIR**”) will only add value if the information collected across the sector is verifiable, consistent, comparable and meaningful. Additionally, the information will only be useful if the target audience is aware of its existence.
20. The key implications of the conditions above are that to ensure comparability between the diverse nature of organisations in the sector, and to ensure that the information available to the public is not misleading, very clear guidelines will be required on a consistent sector-wide method of capturing and providing both qualitative and quantitative information. The information on the SIR may need to be audited, although the subjective nature of the information being captured by the SIR is of the type which does not lend itself easily to audit. Wellcome therefore does not endorse the suggestion that the SIR be professionally audited (although information derived from the financial statements might be subject to audit). A database will also have to be maintained and updated on an ongoing basis of available information.
21. The above highlight several concerns:-
- *Implementation cost.* Any new requests for provision of information should not be onerous on the sector. The requirement will need to be pitched at a level which can be fulfilled by most organisations at very little or no additional implementation costs. Sufficient lead time is also required before mandatory compliance.
 - *Audit.* Potential increase in audit costs will also have to be factored in to the equation. A possibility would be for external auditors to incorporate this within the annual audit and, as described above, to ‘Audit by Exception’².
 - *Communication to the public.* There will be a requirement for database maintenance, publicity of its existence and monitoring. How this can be delivered using the existing resources of the regulators of the sectors will need to be considered. This emphasises the difficulties of having different regulators for different parts of the sector.
22. It is agreed that meaningful Key Performance Indicators (“**KPIs**”) should be considered as a useful benchmark against which to challenge performance improvement, especially if these are developed on a sub-sector basis. They should not however be mandatory. If KPIs are adopted by a subsector, it is critical that KPIs extend to qualitative measures and are not solely based on quantitative measures. In addition to ensuring appropriate KPIs are identified, the criteria for sub-sectoral stratification should also be carefully considered, as these will ultimately determine the usefulness of the performance improvement and benchmarking exercise.
23. Given the subjective nature of the sector performance measures and the potential for the benchmark exercise to be used out of the intended context the implementation of this recommendation is viewed with caution. Inappropriate measures could lead to the wrong signals on the charity’s performance being construed by the general public. The use of KPIs to create league tables would do more damage than good for the sector or specific subsectors.

² To report on apparent misstatement and material inconsistencies with the Financial Statements, as is currently applied to the review by auditors of the Trustee’s Report and Chairman’s Statement.

24. Wellcome endorses disclosing the statement of procedures for the recruitment, induction and training of new trustees but it is essential that the governing body continues to have full discretion over the selection method of its members.

ROLE OF THE CHARITY COMMISSION

[Recommendation 46. The Charity Commission's advisory role should be defined in statute to give a clearer focus on regulatory issues.

Recommendations 2. The Charity Commission should undertake on-going checks on the public character of charities.

Recommendation 47. The Charity Commission should review, with sector participation, and report on the performance of different charitable sub- sectors with a view to correcting information failures and enabling stakeholders to maximise beneficiaries' interests and better fulfil underlying charitable objects.]

25. The enhanced regulatory role of the Charity Commission is endorsed. It is important to ensure public character of charities, but the recommendation that the Charity Commission determines this requires further considerations and further consultation is requested, ensuring full participation of the sector in the process. The primary responsibility for determining whether a charity is acting for public benefit must remain with the charity trustees. In addition, as discussed above, Wellcome believes large charities should be regulated with a lighter touch.
26. Wellcome believes the regulator should continue to be called the "Charity Commission", not renamed the "Charity Regulatory Authority". The change of title would be unnecessary and confusing; it would be far more effective to build on the existing brand name. It is critical to the success of the changes arising out of the Review that additional resources be made available to the Commission.

CAMPAIGNING

[Recommendation 4. That the Charity Commission guidelines on campaigning should be revised so that the tone is less cautionary and puts greater emphasis on the campaigning and other non-party political activities that charities can undertake.]

27. Wellcome endorses this recommendation, but suggests that it may not go far enough in opening up the political process by allowing charities, particularly endowed charities, to participate in the political process where that is an effective way to advance their charitable objects.

NEW LEGAL FORMS FOR CHARITIES

[Recommendation 17. That a new legal form designed specifically for charities, the Charitable Incorporated Organisation (CIO), be introduced, which will only be available to charitable organisations.]

28. Wellcome believes this to be a sensible recommendation, as long as the CIO is an option, not a mandatory form to be used by all charities. This recommendation, however, requires further considerations and further consultation is requested, ensuring full participation of the sector in the process. It is agreed that many charities could benefit from a bespoke form of incorporation which would allow a governing structure that more accurately reflect their objects and purposes. This new form of charity should enable medical research charities to keep home addresses and other personal details of directors or governors out of the public domain.

29. Details and specifics of the recommendation will have to be drawn to ensure seamless implementation with little or no short term requirement for additional administration resources. Additionally there is a question as to how the dual regulation by the Charity Commission and the Companies House will be phased out. Other issues include making sure that (i) the CIO would be eligible under VAT legislation for group relief with subsidiaries, (ii) the benefits of best principles of corporate governance for companies can be adopted by the boards of CIOs, and (iii) the members of the boards have the same protections from personal liability as are available to the directors of companies.

EXEMPT CHARITIES

[Recommendation 57. The monitoring regimes to which housing associations, universities and colleges as exempt organisations are subject should be adapted to cover basic charity law requirements.

Recommendation 58. The reports and accounts of exempt charities should clearly set out the voluntary funds they hold and how they use them. The same level of information about exempt charities as is required of charities should be made accessible on or via the Charity Commission web-site.

Recommendation 59. The Charity Commission should be given a power to investigate exempt organisations on the request of their ‘main regulator’.

Recommendation 60. Larger exempt charities without a ‘main regulator’ should be registered with the Charity Commission.]

30. Wellcome endorses the increased level of monitoring, reporting and accounting outlined for exempt charities. However, we believe that the Review’s recommendations do not go far enough. We would like to see the Charity Commission become the ‘main regulator’ of exempt charities, so that all charities are subject to the same legal and regulatory framework. We believe that this would drive the development of a more flexible regulatory environment for the sector as a whole.
31. In particular, the three regulators for UK universities (the higher education funding councils for England, Scotland and Wales) require the universities to comply with the new “third stream” funding, which is pursued regardless of whether the university is complying with charity law and regulation as interpreted by the Charity Commission. For charities like Wellcome that mainly fund universities, this major difference makes it difficult to operate effectively.
32. For example, the Higher Education Funding Council for England, in its Report 00/52, described HEFCE funding of the “third stream” of the activities of exempt charities (in addition to the traditional charitable areas of teaching and research) as funding to reward and encourage higher education institutions (“**HEIs**”) to enhance their interaction with business. This fund was to provide “a platform of core funding to help HEIs put into practice organisational and structural arrangements for developing and implementing their strategic aims in this area, in order to contribute to economic growth and competitiveness.” In Wellcome’s experience, the “third stream” would only be charitable under limited conditions.
33. If the universities are not subject to the same regulator as the major charities that fund them, charity law, regulation and practice will continue to diverge, leading to confusion and inefficiencies. Wellcome does not want to restrict the activities of the universities

by subjecting them to a more restrictive regulator and regulatory regime; rather, Wellcome would like to be subject to the more liberal views of the regulators of universities.

ETHICAL INVESTMENT POLICY

[Recommendation 23. The ability of charities to follow a broad ethical investment policy should be clarified.]

34. Wellcome agrees with the proposed requirement for a declaration of policies in relation to social, environmental and ethical considerations in investment activities. Whilst improving accountability, such an approach allows individual charities the flexibility to be able to adopt the policies most suited to their individual circumstances.
35. Given the extremely wide variety of possible approaches to socially responsible investment, any Government specification of acceptable investment strategies or products would not be appropriate. For example, charities' investment return requirements (to finance their charitable activities) and their attitude to investment risk will vary enormously and all 'ethical investment' options will need to be appraised in this light. Clarification of the relevant law would be helpful, with any exceptions to the general duty to maximise returns clearly set out, in order that charities may decide whether or not they wish to make use of such exceptions.

ENDORSED RECOMMENDATIONS

36. Wellcome endorses without comment Recommendations 5-8, 21-22, 24, 33, 35-45, 49-55, 61.

RECOMMENDATIONS ON WHICH WE HAVE NO COMMENT

37. Wellcome has no position on Recommendations 9-16, 25-30, 56.

PART B. OTHER ISSUES RAISED BY THE REVIEW

REMUNERATION OF GOVERNING BOARDS

38. The Review notes that *‘payment for acting as a trustee is not generally permissible, and the consultation suggested that its widespread adoption as a recruitment incentive would be resisted by the sector’*. However, whilst this may be the case generally, in the case of several charities including Wellcome, the governing document specifies payment and that is currently permitted. We hope that this will continue to be possible when circumstances justify it. In the case of Wellcome, the taking on of the role of Governor results in a significant opportunity cost because our policy on conflicts of interest and conflicts of time commitments places substantial limits on outside paid consultancy positions. The Governors, unlike the trustees of most smaller charities, have to be able to provide frequent swift responses on documents and have to be available for unscheduled meetings at short notice, which also makes it more difficult for them to take other appointments. The heavy demands on their time go well beyond what can reasonably be expected without payment.
39. Wellcome is allowed to remunerate its Governors, at the levels set in its new Constitution, to be adjusted with effect from 1 April each year by an amount equal to the percentage increase recommended by the Review Body on Senior Salaries in respect of the minima and maxima of the salary pay bands of the Senior Civil Service. An Order of the Charity Commission made in March 2001 permitted the Chairman and Deputy Chairman to be remunerated at levels above the other Governors but, under the new Constitution, Wellcome has to apply to the Charity Commission when it appoints a new Chairman or Deputy Chairman to agree on the levels of remuneration for each of them. Therefore, Wellcome does not have the same flexibility as a public company to attract and pay the best candidates for its two top non-executive positions.

TRANSLATION

40. Wellcome is of the view that, to accomplish the Government’s goals of fostering and promoting entrepreneurialism and to benefit the public by increasing the possibility of translating biomedical research outcomes into practical health benefits (“**translation**”), the definition of public benefit under charity law needs to be expanded. In order for biomedical-research-funding charities to be able to facilitate (particularly the early stages of) translation, the Government should permit them to have a greater role in filling the funding gap for these activities. Charities should be permitted to fund translation activities, in all their aspects, under a much broader interpretation of what benefits the public (and is therefore charitable)

Charities should be regulated similarly to universities

41. Universities in the UK, as charities exempt from registration with, and regulation by, the Charity Commission, have moved aggressively into the area of translation and indeed are required by the UK higher education funding councils to add technology transfer as a third aim to their two traditional aims of teaching and research. Wellcome would like charity law to be expanded to permit large biomedical research charities, which fund in large part through UK universities, to match what the universities are permitted to do.

The University Challenge Fund

42. The problems that the current interpretation of public benefit creates for Wellcome can be illustrated in Wellcome's involvement in the Government-charity University Challenge Fund ("UCF"). The establishment of the first UCF was announced by the Chancellor of the Exchequer as part of his budget in March 1998. The UCF was established to encourage the transfer of academic research outcomes into start-up companies for their development into products to benefit humankind. The DTI contributed £25 million and two charities committed £20 million (of which Wellcome allocated £18 million and the Gatsby Charitable Foundation £2 million), which was fundamental to the success of the initiative.
43. As with any application of its charitable funds, awards made by Wellcome to universities participating in the UCF had to be exclusively for charitable purposes, i.e. within Wellcome's objects and for the benefit of the public. The Charity Commission accepted that both basic and applied research fell either directly or indirectly within the objects of Wellcome (which at the time had not been restated in the new Constitution). However, the Charity Commission at that time took the view that Wellcome funds could not be applied to help the commercialisation process of the start-up companies (such as financing access to managerial skills, preparing business plans and covering the costs of establishing and supporting the companies' 'non-research' costs) because it deemed that such activities taking place through the UCF may not fall within Wellcome's objects. The Charity Commission viewed such activities as being more concerned with venture capital and as such it was suggested that these could only be supported by Wellcome from investment funds.
44. However, funding applied research at the early commercialisation stage is risky from a commercial investment perspective. A start-up company established to effect Translation at this stage is more than likely to lose money over time. This makes it very difficult for a charity to use its investment funds to support this type of activity. Charity law does not permit charities to make investments which are so "speculative" as to fall outside the standard investment criteria to which trustees are required to have regard under the Trustee Act 2000. For this reason, use of Wellcome's investment funds to support the UCF was not considered to be prudent. For the same reason, many early stage start-ups set up to undertake Translation activities are unlikely to attract commercial funding.
45. The UCF exemplifies the difficulty in interpreting public benefit because, in addition to the benefits of Translation, the UCF initiative has many other public benefits for the UK, including creating jobs, strengthening industry, improving local ties between universities, local businesses and providers of finance, creating a strong entrepreneurial culture and benefiting small and medium enterprises ("SMEs") which are believed to be one of the most effective means of creating future economic prosperity. It is believed that none of these real public benefits is currently viewed per se as "charitable" by the Charity Commission but these are clearly the major reasons for the universities, as exempt charities, to be required to engage in technology transfer activities, including Translation.
46. The universities in receipt of UCF awards have found the restriction on the use of Wellcome's funds (i.e. that they may only be applied to fund biomedical and

biochemical research but not on other, 'non-research' costs to support the activities of the start-ups) unhelpful. As a result of this restriction, the UCF will be less effective in obtaining the public benefit of Translation and the wider public benefits.

47. The UCF scenario suggests that there is remaining uncertainty about how far charities can go in supporting the 'non-research' activities of such start-up companies and is a potential *restriction on Wellcome's choices about the way in which it wishes to further its objects*.

Manchester Bioscience Incubator

48. Another example that illustrates the problems that the current interpretation of public benefit has created for Wellcome is the funding of the Manchester Biosciences Incubator. The University of Manchester applied to Wellcome in 1997 for a grant to fund the construction of a research facility that would include incubator space, i.e. space for start-up companies established to transfer academic research outcomes into practical health benefits. Due to legal advice at the time that incubators involved private benefit to such an extent that charitable funding would not be appropriate, Wellcome granted the University of Manchester an award for the construction of the academic space in the facility so the University could use its money to fund the incubator space. This was a convoluted way to achieve an objective which was in the best interests of biomedical research and its Translation, in order to comply with the letter of the law. If Wellcome had been able to fund the incubator directly it would have been far simpler and Wellcome could have secured a share in the value of any intellectual property rights arising proportionate to its contribution to the financing of the incubator space. This could potentially have generated revenue which could have been used to fund other projects in furtherance of Wellcome's objects.

Why wider Translation via start-up companies may be charitably funded

49. Wellcome's Grant Conditions include provision for it to share in the benefits of any commercial exploitation of the research funded by it. In the past, this was usually achieved by means of licensing or royalty type arrangements with existing pharmaceutical or biotechnology companies. However, with the development of the biotechnology sector in the UK, it has been recognised that the establishment of start-up companies to exploit the results of basic and applied research is an alternative option to licensing and royalty arrangements. This is not to say that start-up companies are always the most appropriate vehicle to effect Translation but they may be, particularly in circumstances where larger biotechnology and pharmaceutical companies may be subject to other pressures and hence unable to focus on new research innovations.
50. If Wellcome has funded very early stage commercialisation of research and the project is reaching a successful conclusion, it will almost certainly be in the public interest that it is taken forward. Where the start-up environment is favoured, such a company will need to seek further funding. However, commercial investment will be difficult to attract for the reasons discussed earlier. Although the scientific premise may be extremely interesting, the company must demonstrate that it can manage a host of other factors to make its case. Therefore, the start-up company will have to, for example, prepare a business plan to show how much funding it will need, how long development will take and so on. The better prepared the business plan, the greater the likelihood of

attracting commercial investment. To help the company to attract such commercial investors, Wellcome and/or other charitable monies may be the only source of further funds. Therefore, by enabling Wellcome to provide a reasonable amount of funding to enable the production of a business plan, as well as moving the research forward to an appropriate stage, the possibility of attracting commercial or other investors substantially increases. This would enable Wellcome to further its object of Translation for the public benefit.

51. Wellcome is of the view that using its charitable funds to support such ‘non-research’ costs may actually be necessary to comply with its duty to make sure its charitable funds are spent wisely. To allocate funds to a start-up without supporting its administration and management might of itself be an imprudent course of action if that might lead to failure of the company and Translation not being taken forward. This issue could be resolved by the Charity Commission formally recognising that this type of support to start-ups is inextricably linked to, and indeed may be required for, supporting applied research undertaken by them. This could be achieved by the Charity Commission recognising and incorporating this principle into its final revised Charities and Research paper (last issued in draft in December 2000). If the Charity Commission believes this goes beyond the existing law, legislation would be needed.

Social Investments (previously referred to as “Programme Related Investments”)

52. In May 2001, the Charity Commission issued guidelines on Programme Related Investments (“**PRIs**”) which make clear that charitable funding may be applied to subscribe for equity in a commercial organisation as a means of furthering its charitable objects. The Charity Commission issued revised guidelines in November 2002, renaming PRIs “Social Investments”.
53. The Charity Commission’s Guidelines on Social Investments and the Charity Commission’s acceptance of the modern re-statement of Wellcome’s objects under its new Constitution (which includes Translation) suggest that the Charity Commission’s views on whether Wellcome’s charitable funds could be used to fund such ‘non-research’ costs have changed, since the UCF initiative. The fact that charitable funding may be applied to subscribe for equity suggests that funds may be used to provide support beyond the mere research activities of a start-up company. It would be helpful if this were made explicit. (Please see paragraph 72 below regarding the tax treatment of Social Investments).
54. Wellcome does acknowledge that there is a line to be drawn between the type of charitable activity described above and venture capital activities. Wellcome believes that the judgement as to where that line should be drawn should be at the discretion of charity trustees in the context of their duties overall.

PART C. FISCAL ISSUES OF IMPORTANCE FOR CHARITIES

55. A number of fiscal issues of key importance to the charity sector have been excluded from this Review. These issues will require collaborative work across Government to ensure that the not-for-profit sector achieves its full potential. The fiscal issues of key importance are:

- (a) *Loss of Advance Corporation Tax credit relief.* We have estimated that by 2004 the impact on Wellcome could be over £40 million per annum, with a cumulative cost to date of around £80 million since the decision to abolish the relief in 1999.
- (b) *Irrecoverable VAT.* In Wellcome's 2000/2001 financial year, Wellcome estimated that it was unable to reclaim over £9 million of VAT.
- (c) *VAT on infrastructure.* The construction costs of charitably-funded research facilities, for example, JIF and SRIF buildings, should not attract VAT liability.
- (d) *Capital allowances on research and development relief.*
- (e) *Costs of administering VAT*
- (f) *Tax treatment of Social Investments*
- (g) *Tax treatment of charities undertaking trading activities*
- (h) *Need to modernise sections 505 and 506 tax exemptions (e.g. to reflect total return portfolio theory and Trustee Act 2000 discretion).*

Loss of Advance Corporation Tax credit relief

56. Whilst the vast majority of tax measures to help the charitable sector since the Labour Government took office in 1997 have been geared towards raising the profile of charitable giving from the public, the loss of Advance Corporation Tax (“ACT”) credit has caused a significant decline in the charitable income of endowed charities and will continue to do so in the future. This relief will be completely phased out by 2004, with an estimated impact on Wellcome of a reduction in income of £40 million per annum depending on our portfolio spread in any given year.

57. A possible way of re-structuring this would be to take the existing gift aid mechanisms for contributions by individuals to charities and adapt them to apply to dividend payments to charities. For example, where the recipient of the dividend is a charity, applying the gift aid principles to dividend income would mean that the charity could receive the gross amount of dividend. This may in turn give rise to two options. The charity could either reclaim the tax credit (this is in line with individual gift-aid to charities) or receive the dividend gross (this is parallel to corporate donations to charities). This fiscal measure would therefore avoid reducing the amount of available charitable funding from the sector.

Irrecoverable VAT

58. Charitable activities, be they the giving of grants or the provision of services for no charge, are not considered a business activity and are therefore outside the scope of VAT. Consequently, the input tax on costs associated with such activities is not recoverable by the charity as the charity is treated as the final consumer, even though economically it is not.
59. These features of the VAT regime not only result in a substantial indirect tax burden on charities but also give rise to a number of anomalies. For instance, one consequence of this VAT system is that outsourcing and collaborations are discouraged, even where outsourcing of certain activities would be cost-effective. By outsourcing, a charity will have to pay VAT of 17.5% on the cost of the services, none of which it will be able to recover. This will often offset the lower costs of buying in services compared to providing them in-house. Services provided from one charity to another, i.e. collaborations, could be construed as a taxable service and thus generate additional tax liabilities.
60. Wellcome has estimated that it incurred £9.2 million of irrecoverable VAT in respect of its activities in its 2000/2001 financial year. Approximately half of Wellcome's irrecoverable VAT is due to the direct and overhead costs Wellcome incurs in carrying out its charitable objects. Most of the remainder is VAT on investment advice and management fees, advice that Wellcome takes as a matter of prudence due to the size and complexity of Wellcome's investment portfolio. Wellcome believes that the Government ought to relieve endowed charities of the VAT burden on investment advice and management fees as this is key to the ability of endowed charities to raise funds and would partly compensate for the loss of tax credit relief. Such fees arise on an essential advisory service to charity trustees in fulfilling their duties.
61. The complexity of the VAT legislation creates another major area of costs for charities. These costs generally fall within four categories:
 - (a) administration of the complex VAT regime faced by charities (see paragraph 71 below);
 - (b) unclaimed VAT because of ignorance of reliefs available or because the cost of administering the system outweighs the benefits;
 - (c) the necessity to buy-in professional advice, which is not only expensive but also results in even more irrecoverable VAT (17.5% VAT on professional fees); and
 - (d) additional operating costs incurred by charities in ensuring they avoid a potential VAT liability.
62. Simplification of the charity VAT regime could potentially mitigate the direct and indirect costs of VAT to charities. The fact that VAT is a European tax has been cited in the past as a reason why the Government does not have flexibility on this issue. However, there are a number of ways in which the Government could reduce the VAT burden on charitable activities which would not offend European VAT principles. For example, this could be done by introducing a full or partial VAT refund mechanism whereby charities would be able to reclaim VAT incurred in providing exempt activities or activities outside the scope of VAT. This mechanism is used by HM Treasury to protect local authorities from the unfair effects of VAT. The VAT refunded would then

be used by the charities to fulfil their charitable objects, including the funding of medical research, all for the public benefit.

VAT on infrastructure

63. HM Customs & Excise (“**C&E**”) appear to be advising universities that the construction costs of buildings being funded by the Joint Infrastructure Fund (“**JIF**”) and the Science Research Investment Fund (“**SRIF**”) should attract VAT where research being undertaken in those buildings is carried out by postgraduate students. This is on the basis that C&E deem the universities to be making a supply of education in providing postgraduates with access to research facilities
64. As you know, the JIF, a joint project between HM Government and Wellcome, was one of the major scientific platforms of the 1998 Comprehensive Spending Review. The SRIF was a well-publicised joint follow-up programme by HM Government and Wellcome.
65. Any VAT payable on construction costs would reduce the amount available for construction costs and funding the running costs of the buildings or the costs of the world leading research programmes that these buildings are expected to house. All the major research universities in the UK would be affected. Wellcome does not expect to pay any VAT on the construction costs on these buildings because all of them are intended for charitable academic research.
66. VAT law treats research and education as separate activities and requires the VAT treatment of each to be analysed separately. C&E current interpretation³ of VAT law would, however, make all research a business activity. As a consequence, VAT would be payable on the whole of the construction cost.
67. There is scope for attaching taxable supplies to the business activity; however, because most of the activities of the universities in these buildings would be exempt from VAT, the universities would be unable to recover most of the VAT. The universities would be worse off by the amount of VAT which they could not recover.
68. Wellcome argues that all charitably-funded research - the results of which must be disseminated for the public good and which has the primary purpose of furthering human knowledge - should be treated as “non-business research”. This would enable universities to obtain zero-rating for VAT on buildings used for such research. Wellcome believes HM Government must take responsibility for making clear that zero rating should apply to the construction costs of JIF and SRIF buildings, or for providing additional funds to the universities through grants to pay for the VAT which would be received by HM Treasury if VAT at 17.5% were to become payable.

³ The C&E interpretation appears to be based on the following analysis:

- (a) education is a business activity for the purposes of VAT (this statement is correct);
 - (b) research can only be carried out in furtherance of the university’s educational activities (this statement is not correct under VAT law);
- and therefore
- (c) research is a business activity and a building devoted to research cannot be zero-rated (this is not consistent with VAT law as we understand it).

69. Wellcome, through its membership of the Charities Tax Reform Group (“CTRG”), has been in discussion with C&E about this issue and we are waiting for C&E to formulate their position following discussions. It is vital that this matter is resolved quickly as a number of universities have had to put building projects on hold because they may not have sufficient funds to complete the projects as a result of the current stance being taken by C&E.

Capital allowances on research and development relief

70. The majority of Wellcome’s funds are applied to undertake research and development activities similar to some of those carried out by biotechnology and pharmaceutical companies. Wellcome is unable to benefit from the research and development tax credit incentives introduced by the Finance Act 2000 for small businesses, and the Finance Act 2002 for large companies. Wellcome believes that charitable funding bodies ought to be eligible for analogous incentives and that the rules should be made less restrictive. This would allow financing bodies (such as banks) to use these allowances, with the benefits of this to be received by the charity in the form of lower funding costs. It seems inequitable to favour the commercial sector over the charitable sector where the same activities are being undertaken, particularly given that there is an additional requirement on charities to undertake such activities for the public benefit, which supports the Government’s role in this respect. Also, if we fund research and development our contribution is deducted from a small companies claim for research and development relief but not from a large companies claim for research and development relief. This penalises the small entrepreneur in favour of large pharmaceutical companies.

Administration of VAT issues

71. The compliance costs incurred by Wellcome dealing with the complexity of VAT are around £150,000 per annum. Compliance is significantly more complicated for charities than many businesses because of the level of business/non-business analysis required. This could be easily and significantly simplified if the suggested changes in the law suggested above were implemented.

“Social Investments” (previously “Programme Related Investments”) – tax treatment

72. Wellcome has been informed orally by Inland Revenue that the then-named PRIs would be considered as charitable expenditure and not investment activity. It is anticipated that Social Investments would therefore get the benefit of tax exemptions available to charities, although this has not yet been expressly stated orally or in writing.

73. It is important for the charitable sector to understand the tax position in relation to Social Investments so that it has the option to engage in Social Investments as soon as possible being fully cognisant of the financial implications.

Tax treatment of charities’ trading activities

74. Charities may wish to preserve their trading subsidiaries for reasons such as risk mitigation. We propose that charities should have the option of keeping trading

subsidiaries and the current tax legislation should continue to apply to enable such companies to gift aid taxable profits within nine months of the relevant period.

75. However for charities which do want the flexibility of being able to operate without a “trading” company, it will be necessary to change tax legislation to preserve tax neutrality.
76. To achieve this, changes will need to extend the tax exemption to all Schedule D income including Cases I, II and VI. Schedule D Case VI serves to catch income not specifically taxed elsewhere in the legislation such as underwriting commission, services associated with occupation of charity property and anti-avoidance measures such as TA1998 s 776, (Transactions in Land).
77. Given the charity exemptions already in place charities will not have entered into transactions with the motive of tax avoidance. Other activities are either trading or investment in nature and are taxed under Schedule D Case VI as a legislative convenience. We therefore suggest exemption is extended to all Schedule D source income to enable the report’s recommendation to be achieved.

Need to modernise sections 505 and 506 tax exemptions (e.g. to reflect total return portfolio theory and Trustee Act 2000 discretion.

78. The Trustee Act 2000 greatly liberalised the powers of trustees to adopt a total return approach to managing investment portfolios and to invest in securities that had either not been allowed or had been restricted under previous law and regulation. However, amendments were not made to the tax exemption provisions for charities under Section 505 and 506 of ICTA 1988 to eliminate any ambiguity about the applicability of the exemptions when the new powers are used by trustees.
79. In addition, the Charity Commission’s new guidelines on PRIs need to be reflected by amendments to those sections. Finally, the drafting and operation in practice of the sections are extremely complex, so that simplification in the context of the overall improvements in charity law and regulation contemplated by the Review would be very helpful for the sector.

December 2002