

Third Sector in the Public Sector

The use of third sector organisations (i.e. voluntary or not for profit) to deliver public services has been around for some time. Since the days of industrial philanthropy organisations with a civic purpose have been set up and run to deliver benefits for the continued well being of the public.

With the convergence of increasing pressure on public finances and efficiency gains coupled with the ongoing trend to outsource in the public sector the use of such organisations to deliver services is having a renaissance. Whilst there are numerous examples of charities and industrial provident societies, like the Co-op, that have been doing good works for years their application to delivery of services traditionally provided by your local council is relatively modern.

Why do it? Well from the Council's point of view, outsourcing a service is not only in vogue but fits with wider objectives to streamline its own organisation. Also using a third sector body may help transcend political boundaries (both real and perceived) which fits well with Comprehensive Area Assessment rules and helps cross sector funding. For many the sense of philanthropy or well being is enhanced. But crucially for cash strapped Councils, there may be tax advantages, such as rates relief, and these can be significant.

The shrewd reader may assess that the tax advantage is the main reason for current interest in this area - you might be right- but if that is the case why aren't all Councils outsourcing their leisure services to be run by charitable organisations? Because it's not that easy.

There are four main types of organisation in common usage; Charities, Non Profit Distributing Organisations (NPDOs), Community Interest Companies (CICs), and Industrial Provident Societies (IPs). Here's a quick overview. Key features and differences are summarised in Figure 1.

Charities carry the largest potential commercial benefit in terms of tax advantage (rates and vat) and tend to be the first option to be considered. But you can't just set up a charity and expect to avoid paying taxes!

Charities are authorised and regulated by the Charities Commission who need to be satisfied that the said organisation has charitable objectives. They are challengeable in the Charities Tribunal, which was established by the Charities Act 2006 to hear appeals. Not surprisingly the Charities Commission is pretty cautious and meticulous in its scrutiny of both new applicants and existing charitable organisations.



With financial pressure on public sector being maintained by restrictive spending by government and credit crunch issues, local authorities need to seek new ways of gaining efficiencies in service delivery.

It is generally recognised that procurement savings will no longer be enough and more radical solutions are required.

Could the third sector be the answer?

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| Strategic Partnership | | | | |
|--|---|---|---|---|
| Feature | Charity | NPDO | CIC | IPS |
| Tax advantage | Mandatory relief | Discretionary relief | Discretionary relief | Discretionary relief |
| Regulation | Charity Commission scrutiny | HMRC | HMRC | FSA and Charity Commission and HMRC |
| Additional fund raising potential | Yes | Yes | Yes | Yes |
| Independence | Trustees must be independent of funding sources | Can be part of larger organisation, with same directors | Must pass Community Test and Asset Lock | CC scrutiny will test directors choice of members |
| Distribution of surpluses | In accordance with Charitable objects | To stated charitable causes | Benefit to a community | Members or reinvested |
| Trustees or Directors | Trustees unpaid | Directors (can be paid) | Directors | Directors |
| Companies House registration | usually | Yes | Yes | Yes |

Figure 1 – key features and differences

A charity must have only charitable purposes, and all aspects of public benefit must be met (1). The key thing is to be able to prove that you have charitable objectives (not just say you have). Part of this test is to ensure that the trustees are truly independent of any funding authority (public or private). This is not always straightforward to prove and can become a major challenge of motive!

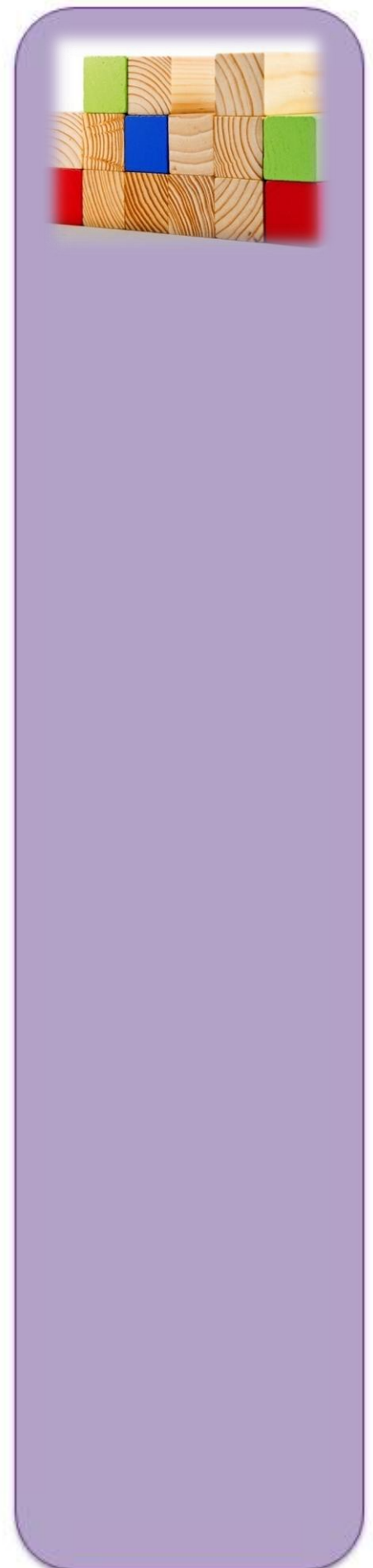
Charities are normally constituted as companies and registered at Companies House but they differ from commercial companies in that they do not operate to make a commercial profit to be distributed to its shareholders (there aren't any) and so does not pay dividends in the conventional sense. Instead of shareholders it has members who between them control the charity/company. These members are typically made up of trustees, other beneficiary or charity and other notable but independent bodies.

There is a board of trustees (also directors of the company) who distribute surpluses to specific charitable causes in accordance with the charity's objects and a charity of any size may well employ an executive to manage the day to day running of the business.

Should the hurdles to become a charity be too high (or the tax benefit is primarily in saving on the rates bill) then an **NPDO** may be an alternative. Its key advantage over a charity is that there is a lower barrier to entry, in that it is not regulated by the Charity Commission, and it also offers a higher level of commercial freedom.

Constituted as a company with paid directors, surplus or profit is not distributed in the form of dividends to shareholders but distributed to agreed priorities, generally including community bodies (such as charities).

Although not scrutinised by the Charity Commission, HMRC will be interested in what you get up to. At a practical level, the level of tax relief may be at the discretion of the rating authority e.g. local authority, and will therefore probably be lower than for a charity which will nearly always qualify for mandatory relief.



Another alternative is to set up a **CIC** which also achieves some discretionary tax advantages. Similar to NPDO a CIC is a limited company but with the specific aim of providing benefit to a community. Its key features are that it has to pass a *community interest test* to establish its community credentials and have an *asset lock* to ensure that assets and profits are suitably dedicated to these causes. Registration and monitoring of CICs is carried out by the Regulator who also has an enforcement role.

IPSS are now regarded as the poorer alternative and are less common than they were. There are different types but we are concerned only with societies set up for the benefit of the community and run for the mutual benefit of their members, with any surplus usually being ploughed back into the organisation to provide better services and facilities.

Regulated by the Financial Services Authority (FSA), some IPSS used to qualify as exempt charities under law (which avoided the need to register with the Charities Commission which we know can be difficult). They are still bound by the principles of charity law with charitable status being granted by HMRC. However under the Charities Act 2006 they now have to register with both the FSA and the Charity Commission (which could result in some IPSS losing charitable status!).

Not surprisingly the organisation with the highest barrier to entry, a charity, carries with it the greatest potential financial advantages.

Financial and tax issues aside though, the use of third sector bodies fits well with the current agenda for taking service provision beyond current political boundaries (in line with Comprehensive Area Assessment). The organisation that delivers the service (libraries, leisure, care for the elderly or whatever) may also be able to expand its offering into other areas, perhaps by servicing neighbouring boroughs or by providing additional complimentary services. In doing this it can bid for funds, independently, which the local authority may not have access to on its own (money again).

Nevertheless, given the difficulties in achieving and retaining charitable status, there is no shortage of organisations willing to have a go. Why? Could it be because there really is money in it? After all, what better credentials could a charitable organisation hope to have - doing good works and saving money - it's a win-win situation.

A final thought - whilst Councils have successfully provided services through charities in the past, as we have said, this is likely to become more difficult as the level of scrutiny increases. I am not aware of any examples, but why shouldn't a contractor for outsourced services do the same? It might be tricky - but not impossible.

(1) Charities and Public Benefit - published by Charity Commission
<http://www.charity-commission.gov.uk/Library/publicbenefit/pdfs/publicbenefittext.pdf>



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