A charitable cause

Nick Booth investigates an alternative approach to helping the public sector meet its service delivery commitments as well as improving efficiency

Given the difficulties in achieving and retaining charitable status, there is still no shortage of organisations willing to have a go

With financial pressures on the public sector being maintained by restrictive spending by the UK government and credit crunch issues, local authorities need to seek new ways of making their service delivery practices more efficient.

It is generally recognised that to satisfy new efficiency targets, procurement savings will no longer be enough and more radical solutions are required, so is the third sector the answer?

The use of third sector organisations (voluntary or not for profit) to deliver public services has been around for some time, harking back to the days when industrial philanthropic organisations with a civic purpose were established to deliver benefits for the continued well-being of the public.

The use of such organisations to deliver services is having a renaissance. This has been influenced by the convergence of increasing pressure on public finances and efficiency gains, coupled with the ongoing trend in outsourcing in the public sector. While there are numerous examples of charities and industrial provident societies, such as the Co-op, their delivery of services, which are traditionally provided by local authorities is relatively modern.

It seems that from local authorities' viewpoints, outsourcing a service is not only in vogue but it also fits with wider objectives to streamline their own organisations. 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 local authorities, there may be tax advantages, such as rates relief, and these can be significant.

You may think that tax advantage is the main reason for interest in this area. Yet, if that is the case, why aren't all local authorities outsourcing their leisure services to be run by charitable organisations? The answer is because it's not as simple as that.

There are four main types of organisation in common usage: charities, non-profit distributing organisations (NPDOs), community interest companies (CICs), and industrial provident societies (IPSs). Figure 1 provides a brief overview of the key features and differences.

Charities carry the largest potential tax advantage (rates and vat) and tend to be the first considered option. But you can't just set up a charity and expect to avoid paying taxes, as charities are authorised and regulated by the Charities Commission. They are challengeable in the Charities Tribunal, which was established by the Charities Act 2006, to hear appeals. Not surprisingly, the Charities Commission is meticulous in its scrutiny of both new applicants and existing charitable organisations.

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 as they do not operate to make a commercial profit that is distributed to its shareholders (as there aren't any) and, therefore, does not pay dividends in the conventional sense.

Instead of shareholders they have members who between them control the charity/company. These members are typically made up of trustees, other beneficiaries or charities and other notable, but independent, bodies.

There is a board of trustees (also directors of the company) who distribute surpluses to charitable causes in accordance with the charity's objectives

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	Must be independent of funding sources	Can be part of larger organisation	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

and a charity of any size may 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 that 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 your activities. At a practical level, the level of tax relief may be at the rating authority's (local authority) discretion. Therefore, it will 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 an NPDO, a CIC is a limited company but with the specific aim of providing a 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 community's benefit and run for the mutual needs of their members, with any surplus usually being ploughed back into the organisation to help 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 difficulties associate with registering with the Charities Commission). 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 may result in some IPSs losing their 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 today's agenda for taking service provision beyond its present political boundaries (in line with Comprehensive Area Assessment). The organisation that delivers the service (e.g. libraries, leisure or care for the elderly) may also be able to expand its offering into other areas, perhaps by servicing neighbouring boroughs or by providing additional complementary services. In doing this it can independently bid for funds which the local authority may not have access to on its own.

Nevertheless, given the difficulties in achieving and retaining charitable status, there is no shortage of organisations willing to have a go. This could 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.

Finally, while local authorities have successfully provided services through charities in the past, this is likely to become more difficult as the level of scrutiny increases. This may cause us to ask why a contractor for outsourced services shouldn't do the same as a local authority? It might be tricky, but it is not impossible.

[1] *Charities and Public Benefit* – published by Charity Commission *www.charity-commission.gov.uk/Library/publicbenefit/pdfs/publicbenefittext.pdf*

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