

INTRODUCTORY NOTE

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Charities and contracts

January 2024

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1 Examples of types of contracts to which charities might be a party¹

- a. Sponsorship agreements with a commercial entity – ie where the commercial entity makes a payment to the charity in return for a significant benefit, such as the prominent display of the charity's name and logo on the charity's publications and at charity events and/or preferential access to charity events.

¹ This list is not exhaustive.

- b. Grant agreements re receipt of funding from another charity, a not for profit organisation, a government body (central or local), a commercial entity or an individual.
- c. Contracts for the delivery of services, e.g. delivering a service on behalf of a local authority or NHS Trust.
- d. Collaboration arrangements with another charity, a not for profit organisation, a government body (central or local) or a commercial entity.
- e. Commercial participation agreements – eg where a retailer makes representations to the public that it will donate a proportion of the retail price of a product to charity. (See section 58 (1) of the Charities Act 1992 (“the 1992 Act”) for the definition of a commercial participator).
- f. Agreement with a professional fundraiser – where a person engaged in a fundraising business solicits or otherwise procures money for charitable purposes - eg an agency which is paid to get donors to sign up for direct debits (chuggers); fundraising consultants that ask for donations; and participants in one or sponsored events whose participation costs are paid by the charity and exceed £1,000 in one year². (See section 58 (1) of the 1992 Act for the definition of a professional fundraiser).
- g. Agreements re the purchase by the charity of goods and/or services – charities do of course purchase a wide variety of goods and services in the course of carrying out their charitable activities. This note concentrates on the situation where a proposed purchase is from a Trustee of the charity or a Connected Person³.

² These examples are not exhaustive

³ A Connected Person includes:

- the spouse (which includes a person living with another as that person’s husband or wife), civil partner (which includes two persons who live together as if they were civil partners), child (which includes a step-child), parent, grandchild, grandparent, brother or sister of a Trustee;
- a business in which a Trustee or a relative of a Trustee (as referred to above) is a partner;
- an institution which is controlled by a Trustee or a relative of a Trustee (as referred to above) or by two or more of such persons when taken together;
- a company in which a Trustee or a relative of a Trustee (as referred to above) has a substantial interest or two or more such persons when taken together have a substantial interest. “Substantial interest” means more than one fifth of the share capital of the company or more than one fifth of the voting rights at a general meeting of the company).

- h. Employment contracts
- i. Agreements relating to the sale of goods or services by the charity – charities do of course sell goods or services in furtherance of their charitable objects - eg an educational charity selling books or an independent school charging school fees. This is known as primary purpose trading and this note does not cover primary purpose trading. Instead, it covers the situation where a charity sells goods or services as a means of raising additional funds – eg the sale of charity merchandise (known as non-primary purpose trading). (Please also note that charities may also engage in trading that is ancillary to the carrying out of its objects – eg the provision of bar facilities at a theatre venue).
- j. Land transactions – many charities own or occupy land. This note covers the disposition and mortgaging of charity land only (as opposed to the acquisition of charity land) as there are some specific rules in this regard.

2 Key legal duties and responsibilities of charity trustees

These are:-

1. Carry out your charity's purposes (also known as objects) for the benefit of the public;
2. Comply with your charity's governing document and the law;
3. Act in your charity's best interests;
4. Manage your charity's resources responsibly (also known as the duty of prudence);
5. Act with reasonable skill and care; and
6. Ensure that your charity is accountable.

See the Charity Commission's core guidance CC3 (link below):

<https://www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3/the-essential-trustee-what-you-need-to-know-what-you-need-to-do#trustees-duties-at-a-glance>

3 Some core principles and considerations re charities and contractual relationships

These include:-

- a. Identify from the outset the type of proposed contractual arrangement – see the examples at section 1 above.
- b. Identify potential risks and undertake appropriate due diligence. Risks might be:-
 - i. reputational (remember: one of the most valuable assets of a charity is its name and reputation);
 - ii. financial; and/or
 - iii. tax related and/or legal (see sections 4 and 5 below for more on this).
- c. Do not further non-charitable purposes:
 - i. A charity cannot allow its assets, e.g. its name and logo or resources (ie money, staff and/or office facilities) to be utilised by a non-charitable organisation (or by a charity that does have compatible objects) without receiving payment in full.
 - ii. Any private benefit to the contracting party flowing from the arrangement must be incidental in that it must either be a necessary result or a by-product of the arrangement – eg
 - receipt of a fair and reasonable payment to the third party regarding the provision to the charity of goods or services by the third party; or
 - a benefit to a third party in respect of which the third party has paid the charity a full market price.

For more complex arrangements with third parties where any potential private benefit to a third party might not be so easily identified (eg a collaboration agreement with a commercial entity), the private benefit rules will need to be carefully considered and expert advice obtained as necessary/appropriate).

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- d. Identify and manage conflicts of interest: see also section 5g and 5h below as there are special rules regarding a proposed payment to a Trustee or Connected Person.

- e. Maintain the charity's independence.
 - i. A third party cannot fetter the discretion of the charity's Trustees regarding the strategic direction of the charity, implementation of policies or their decision-making.

 - ii. There must be no obligation on the part of the charity to purchase or promote the goods of a commercial partner.

- f. Protect the charity's interest by having an agreement in place that⁴:
 - a. clearly sets out the responsibilities and obligations of each party⁵ ;

 - b. includes provisions regarding the use of the charity's name and logo (as relevant);

 - c. includes provisions regarding ownership of intellectual property (as relevant);

 - d. includes provisions regarding data protection matters (as relevant);

 - e. includes confidentiality provisions (as relevant);

 - f. demonstrates the independence of the charity (do not automatically accept the provisions of a standard agreement produced by a third party);

 - g. includes provisions regarding the monitoring of the relationship;

 - h. includes termination provisions (including a provision, as relevant, that allow the charity to terminate if in its reasonable opinion its name and reputation has been, or might be, damaged);

⁴ This list is not exhaustive.

⁵ See also sections 5e and 5f below regarding prescribed agreements with commercial participators and professional fundraisers and section 5g regarding prescribed agreements re the purchase of goods and/or services from a Trustee or Connected Person.

- i. includes dispute resolution provisions; and
- j. clearly sets out the governing law and jurisdiction.

4 Charities and trading

Small scale trading exemption

Charities can engage in non-primary purpose trading (see section 1i above) without incurring tax liability if the trading income does not exceed 25% of all income from all sources in the relevant financial year, subject to a maximum of £80,000. This is known as the small scale trading exemption or de minimis trading exemption.

Trading subsidiaries

If the non-primary purpose trading income is likely to exceed the small scale trading exemption it will be necessary to route the trading through a wholly owned trading subsidiary. (Even if the trading will not exceed the exemption limits, sometimes ventures are routed through a subsidiary to ring fence potential risks).

The establishment of a trading subsidiary and its relationship with its parent charity is a complex area and expert advice should be obtained.

A trading subsidiary must be independent of the charity and operate on an arm's-length basis. A charity cannot subsidise its trading subsidiary and there are restrictions in relation to the investment by a charity in its trading subsidiary.

5 Specific considerations re certain types of contracts

a. Sponsorship agreements

In return for its support to the charity, a sponsor will typically want its name prominently displayed, for example, on charity publications and at charity events (which is akin to advertising by the charity) and/or it may require preferential access to the charity's events. As a consequence, VAT may be payable on all or some of the monies paid to the charity.

It may be necessary to obtain expert tax advice in order to distinguish the "donation element" of a payment from the "provision of services element" of

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the payment, so that only the latter will be subject to VAT.

Depending on the amount of the services element of the payment, it may be necessary to route the sponsor agreement through a trading subsidiary.

b. Funding (grant) agreement or contract for services?

It will be essential to ascertain at the outset which of the above is correct as VAT may be payable for the latter but not the former.

This is a complex area and the outcome often depends on the amount of control that the third party has over the delivery of the project/activity by the charity.

Remember that a charity can only accept funding/enter into a contract for services in relation to activities that fall within the charity's objects (also known as purposes) that are specified in the charity's governing document. Any proposed expansion of a charity's objects will require the prior consent of the Charity Commission.

c. Funding (grant) agreements re receipt of funding by the charity– generally

Restricted funds

A donor may make a donation to a charity on the basis that the donation must be held and applied for specific activities of the charity – known as restricted funds.

Permanent endowment

The donor may also specify that the donation must be held by the charity as permanent endowment – ie that the capital must be retained and only the income can be applied for the purposes of the charity.

Tainted donations

A tainted donation is where an individual donor seeks to make a tax effective donation (via gift aid) to a charity in return for a financial benefit, but in effect he/she is "buying" goods or services from the charity. For example, the donor makes a donation to a hospital charity (via gift aid) and in return he/she

receives treatment (at no additional cost) from the hospital. This arrangement is a transaction rather than a donation.

This is a complex area and expert tax advice should be obtained.

However, if a donor receives a benefit that falls within the Gift Aid benefit rules (see the link below) then the donation will not be a tainted donation.

<https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-3-gift-aid#chapter-318-benefits-received-by-donors-and-connected-persons>

d. Collaborations with a charity with the same or similar objects

With another charity

A charity can enter into a collaboration agreement with another charity which has the same or similar objects (eg sharing of office space and facilities) without having to charge the charity for such use.

With a charity that does not have the same or similar objects, a not for profit organisation; a government body or a commercial entity

It will be essential to establish at the outset the proposed obligations of the charity and what the partner expects from the collaboration. Remember: a charity's resources cannot be utilised for the benefit of the partner without full payment and any benefit to the partner must be incidental.

Such collaboration arrangements are complicated and specialist advice should be obtained.

e. Commercial participation agreements

Prescribed agreement

The arrangement must be recorded in a written agreement that meets the requirements as specified in the 1992 Act, the Charitable Institutions (Fundraising) Regulations 1994 and the Charities (Protection and Social Investment) Act 2016 ("Fundraising Legislation").

Notifiable amount

The commercial participator must clearly state to the public the amount that it will donate to the charity – this is usually expressed to be a specified sum for each product sold.

Tri-partite agreement

Tax considerations mean that it is usual for a charity's trading subsidiary to be a party to the agreement as well as the charity.

Non-compliant agreement

A non-compliant agreement will be unenforceable by the commercial participator without a court order. The charity can also obtain an injunction against the commercial participator.

It is a criminal offence on the part of the commercial participator if it enters into a commercial participator arrangement that does not comply with the provisions of the Fundraising Legislation.

f. Professional fundraisers

Prescribed agreement

Similar to a commercial participator, a professional fundraiser must enter into a prescribed agreement as per the Fundraising Legislation.

Notifiable amount

The professional fundraiser must at the point of solicitation make a statement regarding his/her/its remuneration/expenses.

Non-compliant agreement

A non-compliant agreement will be unenforceable without a court order and the charity will be able to obtain an injunction against the professional fundraiser.

Again, it is a criminal offence on the part of the professional fundraiser if he/she/it fails to comply with the provisions of the Fundraising Legislation.

g. Purchasing goods and/or services (excluding as an employee – see below) from a Trustee or Connected Person

Any such transaction must comply with the provisions of sections 185 to 188 of the Charities Act 2011 (as amended by the Charities Act 2022) (“the 2011 Act”) re:-

prescribed written agreement;
best interests considerations;
non-participation of relevant Trustee in decision making process;
minority of trustees’ benefitting;
no prohibition in charity’s governing document.

h. Employees

These comments are confined to the charity law considerations relating to employees.

Proposed employment of a Trustee or Connected Person

A Trustee or Connected Person cannot be employed by a charity unless expressly authorised in the charity’s governing document (and the insertion of such provision will require prior Charity Commission consent) or unless otherwise expressly authorised by the Charity Commission.

Best person for the job?

Charity trustees must be satisfied that any proposed employee is the best person for the job. This will usually mean that any position should be advertised on the open market. If it is not so advertised, the Trustees should carefully minute why they have reached the conclusion that this was not necessary.

Salary

Salaries must be appropriate in all the circumstances having regard to the size and activities of the charity and the position in question. Charities should be able to demonstrate how employees’ salaries have been benchmarked.

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Overinflated salaries could be regarded as an unauthorised private benefit. The charity's Trustees could find themselves being rendered by the Charity Commission personally liable to repay to the charity the "overpaid" salary (this would be unusual but could happen).

Salaries of £60,000 or more must be reported in the charity's accounts.

Termination of employment contracts/settlements

This is a complex area from both an employment law and charity law perspective. There may also be tax considerations. Expert advice should be obtained.

i. Non-primary purposes sale of goods and/or services by a charity

Unless the sales revenue from non-primary purpose trading falls within the small trading exemption (see 4 above) then such activities will need to be routed through a trading subsidiary. Consequently all relevant agreements will need to be between the third party and the trading subsidiary.

j. Sale and mortgaging of charity land

The sale and mortgaging of charity land is governed by sections 117 to 126 of the 2011 Act (as amended by the Charities Act 2022).

Before selling or mortgaging charity land, charity Trustees must obtain and consider relevant expert advice (as prescribed in the above mentioned legislation).

There are also additional restrictions where land is held on trust for stipulated purposes (eg specified use a village hall or as a school).

Relevant contracts, transfers and mortgage documentation must include specified statements and specified restrictions must be included on the HM Land Registry title.

6 Unincorporated charities

If your charity is unincorporated (eg it is established as a charitable trust, unincorporated association or by virtue of a Charity Commission Scheme), remember that the parties to the contract will be the individual Trustees of the charity and not the charity itself.

This means that it will be the Trustees who can sue and be sued in relation to contracts entered into on behalf of their charity. If the Trustees are sued in relation to such a contract they may, in certain circumstances, be reimbursed from the assets of their charity or they be able to claim on any trustee indemnity insurance that is in place.

The Trustees of unincorporated charities might, however, consider incorporating so that their charity operates as either a charitable company limited by guarantee or a charitable incorporated organisation (CIO). This will mean that contracts will be entered into in the name of the charity and it will, in many cases, give the Trustees limited liability in relation to contracts to which their charity is a party.

Please see our memorandum which explains why charities might incorporate and the procedure in this regard which can be downloaded from our website.

7 Summary

First, it will be necessary to identify at the earliest opportunity the type of contract that the charity is proposing to enter into (see the examples at section 1 above). Charities and their advisers will then need to consider the proposed arrangement in the light of:-

- (a) the trustees' key legal duties and responsibilities (see section 2 above);
- (b) the general core principles referred to at section 3 above;
- (c) any tax and trading considerations (see section 4 above); and
- (d) any specific considerations relevant to the type of contract (see section 5 above).

Finally, do remember that the Trustees of unincorporated charities will be the parties to contracts and consider whether incorporating might be appropriate going forward.

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8 Some relevant Charity Commission guidance

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/677252/Chapter2new.pdf

<https://www.gov.uk/guidance/guidance-for-charities-with-a-connection-to-a-non-charity>

<https://www.gov.uk/government/publications/charities-and-fundraising-cc20>

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/586029/CC37.pdf

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/284729/rs2text.pdf

<https://www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35>

<https://www.gov.uk/guidance/managing-conflicts-of-interest-in-a-charity>

<https://www.gov.uk/government/publications/trustee-expenses-and-payments-cc11>

<https://www.gov.uk/government/publications/sales-leases-transfers-or-mortgages-what-trustees-need-to-know-about-disposing-of-charity-land-cc28/sales-leases-transfers-or-mortgages-what-trustees-need-to-know-about-disposing-of-charity-land>

Please note that this document provides a general summary only and it does not constitute legal advice. It is recommended that specific advice is sought in relation to the particular facts of a given situation.

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