
The Charity Law Practice Review

CHARITABLE COMPANIES CEASING TO BE CHARITABLE

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The Treatment of their General Purpose Property

1. One of the issues brought up in the Charity Commission's recent public consultation document "Maintenance of an Accurate Register" was the question of what should happen to the property of a charitable company which is removed from the register of charities because it no longer is established for exclusively charitable purposes.
2. This loss of charitable status can, of course, come about in one of two ways:
 - The members of the company can use the powers which the Companies Act 1985 gives them to alter the declared objects of the company and/or other provisions in its memorandum and articles of association in such a way that the company is no longer established for *exclusively* charitable purposes;
 - The declared objects of the company are, as a consequence of changed social circumstances and values, no longer construed as requiring the company to devote its property to the *exclusive* pursuit of charitable purposes.
3. There are no longer any explicit limits attached by statute to the type² of changes which the members of a company may make to the objects clause. But even when there were such limits, it was legally possible for the members of a charitable company to use their statutory powers of

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² Section 64 Charities Act 1993 imposes *procedural* constraints on some types of change, see paragraph 13.

constitutional amendment in such a way that the company was no longer established for exclusively charitable purposes.

4. In 1952, the Nathan Report³ drew public attention to the implications of this. If all the general purpose property of a charitable company is held on a trust for its declared objects, the charitable trust will be preserved on a non-charitable amendment of the constitution, on the basis indicated in the case of *Yorkshire Agricultural Society v IRC* [1928] 1 KB 611. But if a charitable company can hold property *otherwise* than on a trust, the statutory powers to change the objects of companies are capable of being used to divert charity assets to non-charitable purposes. For, in the absence of a trust, the property of a company could be applicable for the furtherance of its objects, as those objects are, from time to time, lawfully expressed in its memorandum of association.
5. At that time there was a view that the property of charitable companies is inevitably held on trust, drawing an analogy between the position of charitable companies and the position of charitable corporations established under the Royal prerogative. The property of the latter is undoubtedly held on a trust. But the analogy was not necessarily valid. The Royal prerogative is typically exercised to incorporate an existing association, the property of which, if charitable, would already be held on a trust. But a body formed under what is now section 1 Companies Act 1985 is an entirely new entity, it is not technically the incorporation of an existing association.
6. It was recognised at the time of the preparation of the Charities Bill in 1959 that the foundation of this view was shaky. Those instructing Parliamentary Counsel said –

“It is doubtful whether this line would be upheld by the Courts; and it is not a satisfactory basis for legislation. A trust and a company are two different concepts governed by their own rules and shaped by their own basis of legal theory. Accordingly it is more convenient to treat a gift to a charitable company as a gift to the company for its own use and benefit (in the absence of course, of some express stipulation to the contrary) and to meet the case by disabling the company, so as to keep it within such bounds as the public interest requires....The first aspect of the basic theory of company law which requires attention is that it proceeds upon the footing that the net assets of a company belong ultimately to its

members. Its assets are devoted to the purposes for which the company is established for as long as the members choose and no longer..... In the present state of the law, it appears quite possible for members of a collecting company to take cash collected for one purpose and devote it to another, or to dissolve the company and put it in their pockets without any legal check; and the fact that the looser organisation of the company gives greater opportunity of this kind than a trust, is no argument for laxer supervision of the company."

7. Indeed, it could be argued that the doctrine of the merger of legal and equitable estates means that a charitable company could *only* hold its general purpose property beneficially.
8. The solution originally proposed was to require the consent of the Commission to any change to the objects of a charitable company, and to give the Commission a statutory power to apportion any corporate property of a charitable company which, with such consent, reconstituted in a non-charitable way. Thus part of the corporate property of the company would stay with the company, applicable for its now non-charitable objects, and part would be applied by scheme for suitable charitable purposes, reflecting the objects of the company as they stood prior to the constitutional change.
9. The solution eventually found in the Charities Act 1960 was rather simpler. Although the wording of the relevant provision was, and remains, somewhat Delphic, the general view is that it has the effect of imposing a statutory trust on any general purpose property of the company⁴ which is held at the date of the constitutional change and which is not *already* held on a trust. The trust is effectively the same as the one which would be imposed by the application of the *Yorkshire Agricultural Society* principle if the charity had been an unincorporated association, i.e. for the furtherance of the charitable objects of the company as they were immediately prior to the relevant constitutional change.
10. It has, since 1960, become clear that those responsible for the drafting of the Charities Bill were right to question the legal justification for the view that the property of a charitable company is necessarily held on a trust.

⁴ Other than property representing subscribed capital, any rights in respect of uncalled share capital, and, in the case of a guarantee company, any rights enjoyed by the company under the guarantee.

In *Rabin v Gerson Berger Association Limited* (1987 – not reported on this point), Ralph Gibson LJ said –

“The principle of law, as I understand it, is that a company for exclusively charitable purposes does not, by reason only of that attribute, hold all its property on trust; it may own property beneficially which, by reason of its constitution, it must apply to its charitable purposes, but it may also hold property as trustee and in my judgment the trust may be real and continuing notwithstanding the fact that, at the creation of the trust the purposes of the trust are indistinguishable from the purposes of the company under its constitution..”

12. The Court of Appeal thus rejected not only the view that the general purpose property of a charitable company is *always* held on a trust, but also the view that the doctrine of the merger of legal and equitable estates means that the charitable company *always* held its general purpose property beneficially. The latter argument was rejected on the basis that the doctrine of merger has no application to charitable trusts where the beneficial interest is considered to lie with the public at large. The basis upon which the general purpose property of a charitable company is held thus depends on the circumstances in which that property was acquired.
13. Since February 1991⁵, charitable companies have required the prior written consent of the Commission to any changes to their objects clause, and this requirement was extended in January 1993⁶ to certain other provisions of the memorandum and articles of association. But, in appropriate cases, the Commission can and will give consent to constitutional changes which have the effect of terminating the company's charitable status. Where they do so, the statutory trust referred to in paragraph 9 will be applied to the general purpose property of the company not already held on a trust.
14. This leaves the other case, where the company's loss of charitable status is the result not of a change in its declared objects etc but rather of changed social circumstances and values leading to the perception that the declared objects, without any change, no longer require the company to devote its property to the exclusive pursuit of charitable purposes. The position never appears to have been judicially considered.

⁵ When section 111 Companies Act 1989 came into force.

⁶ When sections 40-42 Charities Act 1992 came into force.

15. One legal theory examined in the recent consultation paper was that a loss of charitable status simply could not happen in this way at all. The declared objects of the company would simply metamorphose in this event into objects which remained charitable. None of the responders to the consultation favoured this view, which seems incompatible with the underlying requirement of company law that there should be an accurate public record of the objects of a company, and that record is set out in its memorandum of association.
16. Subject to this, it must be accepted as a legal possibility that a charitable company can cease to be charitable on this basis, without any explicit change to its constitution. If this happens, it is clear that the Commission is under a duty to remove the company from the register of charities, for the company no longer appears to be a charity⁷. If the Commission removes a company from the register on the basis that its objects, though unchanged, no longer require the company to devote its property to the exclusive pursuit of charitable purposes, and that decision is not successfully challenged, what are the consequences for the general purpose property of the company?
17. The removal from the register of charities is not, of course, conclusive evidence that the company is not still legally constituted as a charity, even if there is no appeal against the decision to remove. But the Commission would rationally be bound to consider whether, on the basis of its perception that the company had ceased to be a charity, there was a subsisting charitable interest in its property which the Commission ought to take appropriate steps to enforce.
18. Such an interest would clearly continue in any general purpose property held by the company on a trust. Section 13(1)(e)(ii) Charities Act 1993 provides the basis for making a scheme in these circumstances. But what is the position in the case of the general purpose property of a company which is *not* held on a trust?
19. As a matter purely of company law, it would seem clear that such property continues to be applicable for the declared objects of the company, notwithstanding the altered perception of their legal effect. On the present hypothesis that, of course, means that the property comes to be applicable for non-charitable purposes. It would seem that the only legal basis for an assertion that there is a continuing charitable interest in the corporate property of a company the objects of which have in this way ceased to be

regarded as charitable is that a constructive trust for purposes which continue to be charitable is applied to the property.

20. The consultation paper considered the arguments for and against this. Reference was made to extracts from the judgements in the cases of *Liverpool and District Hospital for Diseases of the Heart v Attorney-General* [1981] 1 Ch 193, and *re Vernon's Will Trusts* [1972] Ch 300. These two cases tended to suggest that the courts *would* seek to find some mechanism to ensure a continuing charitable interest in the corporate property of a company which had ceased to be regarded as charitable on the basis that changed social circumstances and values had led to the perception that the declared objects no longer required the company to devote its property to the exclusive pursuit of charitable purposes.
21. In neither of these cases was the point articulated in this way, but the only apparently available mechanism seems, as suggested above, to be the imposition of a constructive trust for charitable purposes on the corporate property of a company which finds itself in these circumstances. This seems to give rise to a number of possible difficulties –
 - (a) The normal basis for imposing a constructive trust on what is apparently beneficially owned property is that it would be fraudulent, immoral or “unconscionable” to allow the apparent owner to assert beneficial ownership. From one perspective it might seem “unconscionable” that a company which has built up its resources whilst it enjoyed the fiscal and other advantages of being recognised as a charity should continue to enjoy the use of those resources when it is no longer recognised as a charity. On the other hand, the company might argue that it had been supported primarily because its supporters were concerned to further its declared objects, and were still concerned to further those objects, notwithstanding the fact that they were no longer regarded as charitable. On that basis, it might be said that the imposition of a constructive trust would amount to an interference with the proprietary rights of the company, contrary to article 1 of the first protocol to the European Convention on Human Rights.

Expert advice which the Commission received before publishing the consultation paper suggested that a decision to impose a constructive trust in these circumstances would not be regarded as violating a convention right, so long as the court in this country considered that it was fair in all the circumstances to impose such a trust. But the question remains whether the court would, in fact, think it *was* fair

to impose such a trust. There do not appear to be any decided cases in which the court has imposed a constructive trust where there is the sort of moral equivalence implicit in the competing arguments referred to above.

- (b) If a constructive trust *is* imposed in these circumstances, why not, *a fortiori*, also in the circumstance where the loss of charitable status is the result of constitutional change? There is no suggestion in the instructions to Counsel preparing the Charities Bill which was enacted in 1960 that this was even considered as a possible solution to the difficulty. It was clearly thought that legislative intervention was necessary to impose an explicit statutory trust where the loss of charitable status was the result of constitutional change.
- (c) If a constructive trust *is* imposed, at what point does it take effect? The date when the company is removed from the register of charities would be convenient in the case of companies which are registered with the Commission, but the principle would apply equally to companies which, whilst they were charities, were excepted or exempt charities.
- (d) What is the effect of the imposition of the trust on the rights of the company's creditors? The position of third parties dealing with a company as the beneficial owner of property is not, of course, the same as the position of third parties dealing with a company as a charity trustee of property. Does consideration of the position of third parties affect the decision as to whether or not a constructive trust is imposed at all? Or is the remedy of unsatisfied creditors of the company dependent on their ability to set the trust aside under the provisions of insolvency legislation?
- (e) There are two apparently analogous situations where the court has declined to impose a constructive trust on the corporate property of a company.

The first is where a charitable company received gifts after it had gone into insolvent liquidation but before it had been dissolved⁸. The court accepted that, had the donors appreciated the financial position of the company, they probably would not have made gifts which, in the absence of the imposition of a trust, could only have

the effect of increasing the fund available for the company's creditors. The imposition of a constructive trust on the gifts would, of course, have excluded them from the resources of the company available to creditors under insolvency legislation. Nevertheless the gifts in terms formed part of the corporate property of the insolvent company available to its creditors, and the judge declined to accept the argument that, in the circumstances in which they were made, it would be unconscionable for the liquidator to assert the company's beneficial ownership of them. The gifts therefore increased the funds of the company available to its creditors.

The second situation is where a charitable company is removed from the register of companies, and so dissolved, typically for failing to make returns, whilst it still has corporate property. That property becomes *bona vacantia* in the same way that the property of a non-charitable company would in similar circumstances. Again the imposition of a constructive trust for charity in these circumstances would prevent the corporate property from becoming *bona vacantia* thereby protecting the charitable interest in it. It has, however, been held⁹ that the way to protect the charitable interest is to revert to the *status quo ante* by having the company put back on the register under section 651 or 653 Companies Act 1985.

22. However, the responders to the consultation considered that, notwithstanding these difficulties, the court would prefer the claims of charity to the claims of the members of the company which found itself in these circumstances. It was thought that the court *would* be likely to impose a constructive charitable trust on the corporate property of the company. That conclusion certainly has the advantage of avoiding the drawing of any distinction between the position of once charitable unincorporated associations, the property of which is inevitably held on a trust, and the position of once charitable companies the property of which may not be.
23. As mentioned above, the issue never appears to have been litigated here. It is not, therefore, possible to give a definite answer to the legal question. The issue may, of course, never arise. But, if it did, it would be unrealistic to expect that the members and directors of the company affected would make no attempt to resist the claim that a constructive charitable trust had been imposed on its corporate property. What steps the Commission took to assert the existence of such a trust, and to enforce it, would inevitably have to depend on the advice which it received at the time.