THE NEW PUBLIC BENEFIT TEST - AN UNEXPLODED BOMB?

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The Strategy Unit Report of September 2002, *Private Action, Public Benefit* ("the Report"), (succinctly analysed by Hubert Picarda QC in Redefining "Charity " in England and Wales, Eire and Australia[2]) contained proposals for the most comprehensive reform of charity law certainly since Lord Macnaghten laid down the "four heads" in *Income Tax Special Purposes Commissioners v Pemse*[3] and perhaps since the Charitable Uses Act 1601, the preamble of which is still the starting point for deciding whether a purpose is charitable.

The most controversial of the proposed changes is the reform of the so-called "public benefit test". Under the existing law, charitable purposes which fall within three of Lord Macnaghten's heads - namely the advancement of religion, the advancement of education or other purposes beneficial to the community - must (to a greater or lesser extent depending on which head applies) confer a tangible benefit directly or indirectly on the public[4] (the public benefit test has been held not to apply to purposes falling within the "first head", the relief of poverty[5]). For purposes within the education and religion heads, public benefit is

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2 *Charity Law and Practice Review*, Volume 8, Issue 1, 2002, pp 1-15. The Government substantially adopted most of the recommendations in the Report in the Charities Bill, which was introduced in the House of Lords on 20 December 2004. Although the Government called a General Election for 5 May 2005, as a result of which the Bill failed to complete its passage though Parliament, the Labour Party has stated that it intends to "reintroduce the widely supported reforms in the Charities Bill" (The Labour Party Manifesto 2005 at p. 105).

3 [1891] AC 531 at 583.

4 *Gilmour v Coats* [1949] AC 426.

5 *Dingle v Turner* [1972] AC 601 *per* Lord Cross of Chelsea at 623.

presumed to exist unless there is evidence to the contrary. The test is presently applied only when a trust or organisation makes its application to the Charity Commission for registration.

The Report states that "public benefit should continue to be one of the essential requirements of charitable status."[6] It proposed that ten purposes should replace the four heads,[7] and that the presumption of public benefit should be abolished.[8] Most radically, it suggests that the Charity Commission should "undertake a rolling programme which reviews public character,"[9] essentially of organisations charging fees that are not affordable to large sections of the population.[10] The Report singled out independent schools, stating that they will have to "make significant provision for those who cannot pay full fees"[11]. Similar considerations would arise for private hospitals. Fee-charging charities will be asked to complete an initial return stating what they do to widen access to their facilities.[12] If the measures they take are deemed inadequate, they will be given the chance to "develop their provision of public benefit", but ultimately face losing their charitable status.[13]

The Report opined that the majority of independent schools probably already make sufficient provision for wider access and that in most cases no further

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6 p.39 para 4.15.

7 p.38 paras 4.12-13. Clause 2 of the Charities Bill proposes that twelve purposes should replace the four heads..

8 p.40 para 4.18. This recommendation has been adopted in clause 3 of the Charities Bill.

9 *ibid.*

10 p.41 para 4.26.

11 *ibid.*

12 p.41 para 4.28.

13 p.42 para 4.30. The Joint Committee on the Draft Charities Bill, which was published for consultation in May 2004, recommended in its report that the real Bill should include provisions to clarify the effect of the loss of charitable status on the assets of a charity. This recommendation was rejected by the Government on the grounds that the current law, as explained in the Charity Commission publication "Maintenance of an Accurate Register" (see www.charitycommission.gov.uk/publications/rr6.pdf), provides an adequate basis for determining what happens to the assets of an organization that ceases to be a charity (response no. 9 of the Government Reply to the Report from the Joint Committee on the draft Charities Bill, December 2004, www.official-documents.co.uk/document/cm64/6440/6440.htm).

inquiry will be necessary after the initial return.[14] However, the extent of the provision that will be required is uncertain. It is likely that some charities will find it impractical to meet the requirements, and these institutions face a sanction which has no equivalent under the present law.

Loss of charitable status will have obvious disadvantages, such as the inability to benefit from tax reliefs and Gift Aid on donations, but these would not in most cases be fatal to the organisations or trusts in question (referred to in the rest of this article as "ex-charities").

However, the change would have more drastic side effects, especially on unincorporated ex-charities, which do not appear to have been addressed in the Report.

Firstly, non-charitable purpose trusts are currently illegal. As a result, the governing trusts of any ex-charities would be voidable[15] on application to the courts. This problem could be avoided either by legalising non-charitable purpose trusts or perhaps by allowing the excharities to incorporate as Community Interest Companies ("ClCs"), a new legal form recommended in the Report[16] (which requires a company to demonstrate that its objects are in the public and community interest at registration, but imposes no ongoing checks as to the extent of its public benefit).

Secondly, it is a basic legal principle that property dedicated to charity must be applied for charitable purposes. This principle is most often invoked in the context of imperfect gifts by will to charity, where there would otherwise be a resulting trust for the testator's residuary estate or next of kin, contrary to his or her intention.[17] If possible, the gift will be applied under the doctrine of "cy pr&' to charitable objects as near as possible to the original ones. Charities Act 1993 section 13(l)(e)(ii), which has not yet been the subject of any reported cases, provides that a "*cy près*" circumstance will also arise

> *"where the original purposes [of a gift] … have, since they were laid*

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14 14 p.41 para 4.28. Clause 4 of the Charities Bill requires the Charity Commission to issue guidance on meeting the new public benefit test. The Charity Commission published draft guidance on 20 January 2005 with the intention of consulting groups from different sectors and revising the guidance in due course.

15 A more accurate term than "void" - see Jaconelli, *Independent Schools, Purpose Trusts and Human Rights,* [1996] Conv. 24, p 27-8.

16 see pp 53-55 paras 5.19-5.32 for details.

17 see *Re Wright* [1954] Ch 347 per Romer LJ at 363.

> *down … ceased, as being useless or harmful to the community or for other reasons, to be in law charitable".*

This section is thought to apply to removal of charitable status by statute.[18] Furthermore, the trustees of a charity affected by the section are "under a duty, where the case permits and requires the property or some part of it to be applied *cy près*, to secure its effective use for charity by taking steps to enable it to be so applied."[19] In other words, a significant number of ex-charities would be deprived of most or all of their assets.

This problem is particularly acute in the case of ex-charities that have permanent endowments. They would lose the capital that they have relied on to guarantee their existence by producing a regular income unaffected by the whims of potential donors. This loss would be catastrophic for educational institutions, some of which have relied on such endowments for more than 500 years.

It is impossible to predict exactly what will happen, as the Charity Commission did not take its only available opportunity to give effect to section 13(l)(e)(ii). In 1993, the Commission refused to register two rifle clubs on the grounds that their purposes were no longer charitable.[20] However, the Commission did not remove existing charitable rifle clubs from the register.[21] The wording of the Report suggests that its attitude will not be so *laissez-faire* in the future. If so, the consequences of deregistration under the present law are clearly unfair and unacceptable, and must be addressed before the Report's recommendations take effect.

The fairest way to resolve this problem would be to include in the statute enacting the changes to the public benefit test a transitional provision that the assets held by ex-charities at the time of their loss of status should be retained by them and applied for their purposes at the time of the change. Although this would not be in accordance with the wishes of any donors that had a general charitable intention in giving to these ex-charities, it is a far more equitable solution than condemning some of them to extinction by the stroke of a draftsman's pen.

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18 see Luxton, *The Law of Charities,* 1st Edition (Oxford University Press 2001) p 572 para 15.77; for a contrary view see Jaconelli, *op. cit., pp* 30-32 - the author points out elsewhere in the article that even if the section does not apply, the property would be held on resulting trusts for the donors or their estates, so the ex-charities would suffer either way.

19 Charities Act 1993 section 13(5).

20 (1993) 1 Decisions pp 4-13.

21 apparently in contravention of Charities Act 1993 section 3(4).