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PULSE
Quarterly Newsletter of Deloitte's Charities and Not for Profit Group

Happy New Year!

Welcome to the first edition of Pulse in 2014. A new year brings with it many challenges, but all economic indicators are now pointing in one direction; at last we seem to be coming out of the recession and be heading for better times – charities should capitalise on this and ensure they are well placed to benefit from the positive attributes that good economic conditions and growth bring.

Please note that the views expressed in this publication are those of the authors and not of Deloitte. In the complicated environment we all operate, always seek professional advice specifically and don't rely on contents of articles that have been written for general guidance only.

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Gift aid update

Introduction

April saw the Treasury bring in a number of changes and updates to the Gift Aid system.

Recent statistics show that Gift Aid provided over £1bn of additional funding to charities and qualifying not for profit organisations in 2012 alone which is an enormous amount of funding. However, the same research also showed that this was claimed by only 44% of eligible organisations (equating to approximately 80,000 organisations) and furthermore that there is an estimated £800m unclaimed each year.

The common theme of all of the measures introduced is to maximise qualifying Gift Aid claims.

There are a variety of reasons why there are 56% of charities in England and Wales not currently claiming Gift Aid ranging from, amongst others:

- the claim system itself being too complex and cumbersome for some smaller charities;
- the time and effort required for small claims for relatively little gain; and
- having the appropriate declarations and systems in place to capture all of the information necessary to make a qualifying claim.

Whatever the reason may be, the Treasury announced a number of measures to increase Gift Aid claims and also launched a Consultation Document in July 2013 titled "Gift Aid and digital giving" that looks to the future of Gift Aid and how the current system can be adapted to keep pace with the modern ways that donations are made and the prospect of a universal Gift Aid declaration.

Retail Gift Aid Scheme

The first of the updates in April 2013 was made to the Retail Gift Aid scheme. This scheme allows charities to act as agents, selling goods on behalf of those donating clothes and other items to charity shops. With the correct declaration and staff training in place, once the donated goods are sold, the proceeds received can be treated as a cash donation and Gift Aid claimed.

Charities and trading companies are advised to follow the HMRC guidance carefully in operating the scheme as HMRC have made changes to the "standard method" of claims.

Charities Online

September 2013 saw the deadline pass for a raft of new measures introduced in April 2013 to come in to effect with a push to encourage charities to register to complete Gift Aid claims online. The manual paper approach still exists although a new paper form ChR1 replaces the old form R68i (from the end of September form R68i will no longer be accepted).

Charities Online should bring a number of benefits such as faster repayment times (quoted as fifteen days rather than the previous thirty), error checking of the form before the claim is made and immediate acknowledgement of receipt of the claim.

There are other changes to the system that aren't so favourable including increased information requirements for the declaration to qualify including the donor address and postcode (this is so that HMRC has increased traceability from the donation to the personal tax affairs of the donor).

We are expecting this to lead to the requirement to update systems of some of the larger charities particularly those who will file claims via their own software as this will need to demonstrate it can collate all of the additional information required and show the audit trail from the donation made to the Gift Aid claim. Other problematic areas include enduring Gift Aid claims where the information the charity holds about the donors may not be sufficient for future claims and how this will be updated.

Gift Aid Small Donations Scheme (GASDS)

Another change that came in to effect for small cash donations made on or after 6 April 2013 was the Gift Aid Small Donations Scheme (GASDS). This scheme allows charities to claim a Gift Aid "top up" payment on small cash donations received without the requirement to have a declaration in place subject to some rules.

Firstly, small donations means those that are less than £20 cash and for every £10 GASDS claimed, this must be matched to a £1 "ordinary style" Gift Aid claim. The maximum claim is £5,000 therefore the "top up" value is £1,250 and this scheme is designed to capture donations from such things as collection tins, cake sales and street collections.

In order to make a claim the charity must have the following:

- made an ordinary style Gift Aid claim in at least two of the last four years and at least every other year;
- have not received any penalties in relation to Gift Aid in the current or previous year;
- make a claim within 2 years of the end of the accounting period in which the donation was made; and
- hold records to show the donation was made and banked in the UK and was less than £20.

As can be seen from the above, the GASDS scheme appears complex for what may be a relatively small uplift in an overall Gift Aid claim and this is the initial feedback on the system. In response HMRC issued new guidance on 2 October 2013 which can be found on their website.

Gift Aid and Digital Giving – the Future

The Gift Aid system has been in place for over 20 years and was designed at a time when it was expected that the donor would have time to complete a declaration however the Treasury have acknowledged that the Gift Aid systems have not kept pace with modern life and methods of giving particularly through digital channels.

In July 2013 a consultation document was launched which asked for comments on three key areas;

- giving through text messages and online – "Digital Giving";
- Gift Aid through intermediaries;
- the use of a Universal Gift Aid declaration; and
- as well as any other comments and ideas.

All of the above has the intention of maximising Gift Aid claims and easing the burden of completing declarations for regular donors and those who donate to a number of charities.

The consultation

The consultation period is now closed but a summary of responses should be available later this year with any new legislation put forward in Finance Bill 2014 or 2015. We will keep you updated on the responses when they are published.

Pooled and segregated investing for charities

In this article, we look at the differences between pooled and segregated approaches to investing, and explore the implications of each for UK charities

Characteristics of pooled and segregated funds

A **pooled fund** gathers the assets of a number of investors in a single collective investment scheme, which is invested in accordance with a given set of objectives. The assets are held by the fund, and the investor owns shares (or units) in that fund of a value equivalent to the size of its investment. Pooled funds are referred to by different names, the precise name depending on the legal structure of the fund and its ability to accept new entrants. All such schemes offer the benefit of diversification to investors, irrespective of the amount invested. As pooled funds combine a number of clients' assets, a smaller investment is required to achieve diversification of assets than is the case with a segregated fund.

In a **segregated fund**, also known as a 'separately managed account', the assets of an investor are managed separately in a distinct account. Segregated funds are tailored and adapted to particular client requirements, for example to reflect the avoidance of investment in particular sectors or stocks. A pooled fund must adhere to its objectives and defined parameters, and does not reflect any specific client preferences.

In reality, an investor's portfolio may well combine elements of both pooled and segregated approaches. An investment manager may, for example, hold units in pooled funds for a client who, on a direct basis, has insufficient resources to achieve appropriate diversification in particular asset classes through direct holdings. Such asset classes might include emerging-market equities, commercial property and 'alternatives'. A manager may hold such pooled-fund interests alongside a number of direct equities and bonds.

It should be emphasised that, whether a charity uses a pooled or segregated approach, the value of its investments can fall as well as rise, and it may get back less than it originally invested.

Choices for charities

In determining which arrangement is in its best interests, a charity should pursue an approach that concurs with its investment objectives most effectively. In this context, it is worth noting that a growing variety of pooled funds is available to meet a broad range of charity-investor objectives, including those focused on income generation, ethical investing, and absolute-return investing.

From a diversification perspective, the level at which one might consider a segregated rather than pooled approach can be debated. Nonetheless, there may be good reasons to take one or other approach, and a pooled approach may be appropriate even for much larger investments. These reasons include the benefit of locking into an investment manager's flagship strategies, which, in contrast with segregated funds, will tend to have investment-advisor ratings and a publicly available track record. Other important benefits include economies of scale (cost), custody charges, and ease of administration, including fewer contract notes and corporate actions, and simplified dividend payments.

On a related point, when putting new money into a portfolio, or making a capital withdrawal from it, it is easier to do so when holding a pooled fund: it simply entails buying or selling units in one transaction. By contrast, a segregated-fund investor would most probably want to sell part, or add to most, of the individual holdings in a portfolio in such circumstances, in order to preserve the structure of the portfolio. This would clearly involve multiple transactions, and, when selling, also bring the added burden for charities of having to account for numerous realised gains and losses.

Ethical and socially responsible investing considerations

Many investment managers provide charity specific funds so it is useful to identify an investment manager that deals with charity specific funds.

Responsible investment should be integral to your analysis of investment opportunities.

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In addition, many charities have an ethical policy, and the precise nature of such policies differs from one charity to another. In general, pooled funds are less flexible in being able to meet investors' ethical criteria than segregated funds, which can be managed to reflect the precise ethical concerns of the individual charity. However, it is possible to invest in pooled funds which have responsible and ethical investment incorporated in their objectives.

Funds may be created specifically for charities which seek to meet the responsible and ethical-investing requirements of many charities by screening the investment universe for negative and positive criteria. Specifically, these may exclude companies which have exposure[1] to one (or more) of these activities:

- Tobacco production and sale
- Alcohol production and sale
- Gambling
- Pornography
- Animal testing for non-medical purposes
- Abortion
- Armaments

In addition, they may exclude companies in relation to which there are significant concerns about the following:

- Environmental issues
- Human rights

Inclusions (positive criteria) include companies which promote sustainability through:

- Corporate governance
- Equal opportunities
- Environmental issues
- Human rights
- Community involvement
- Positive products and services[2]

Other considerations

Ease of selection and monitoring

A segregated approach allows investors to set, and maintain close control of, portfolio specifications, and to make adjustments based on changing circumstances. Segregated arrangements require a greater degree of involvement from trustees in establishing and maintaining investment guidelines. This involvement may be welcomed by trustees who wish to keep more direct control, and who have the requisite time and experience to do so. Segregated investment management generally gives rise to a higher volume of paperwork, and to more onerous auditing requirements than pooled investing.

Pooled funds, by contrast, have their investment guidelines described in a prospectus or a trust deed, as well as in related marketing material. The depth of publicly available information about their performance and composition, as well as the typical clarity of their investment objectives, may simplify the due diligence involved in selecting a manager and initiating investment. In terms of establishing and monitoring their investment arrangements, trustees should naturally seek to ensure that the level of guidance they obtain is appropriate to their requirements.

Costs

Fees for investment management services vary according to a number of factors, including the investment objective and the size of a portfolio. For a given size of investment, fees tend to be lower for a pooled fund investment than a segregated portfolio. In addition, VAT is not applied to the management fees of most pooled funds, including Non-UCITS Retail Schemes (NURSs) but excluding Common Investment Funds. For segregated client accounts, fees are calculated on an individual basis. Unlike most pooled funds, management fees for segregated mandates are subject to VAT.

Charity investors should insist on transparency of all fee charges for both pooled and segregated funds. I believe investors should be particularly cautious about the lack of transparency and 'double-charging' which can characterise multi-manager arrangements, in which a notionally segregated approach (for which the investor pays a fee) entails the holding of a range of pooled funds, which levy additional fees.

Conclusion

Pooled and segregated investment approaches have some distinct features, but they also share some characteristics. Both are intended, ultimately, to enable the fulfilment of investors' objectives.

In pursuing one method over the other, a charity should seek to ensure that its chosen approach is appropriate for the task of trying to meet its investment objectives. Insofar as the charity has an ethical investment policy, it should ensure that the solution it chooses is equipped to meet the demands of that policy.

Some charities will, by virtue of their limited resources, achieve diversification benefits via a pooled approach that they would struggle to replicate in a segregated mandate. Even for larger charities, however, pooled investing may offer an administratively simple and cost-effective way to harness the flagship, advisor-rated strategies of their chosen investment manager.

1 **Exposure limits will be defined on an activity basis, e.g. "a company with any turnover from tobacco production will be excluded", or "companies with over 10% of turnover from tobacco sales will be excluded".**

2 **Positive products and services include water scarcity solutions, climate change solutions, waste solutions, environmental solutions, and safety equipment.**

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Trustees must have regard to the new benefit on public benefit

After much consultation and deliberation on the implications of the decision of the Upper Tribunal in the Independent Schools Council (ISC) case handed down on 13th October 2011, the Charity Commission published its revised public benefit 'guides' on 16th September 2013.

The first of the easy-to-read suite of documents gives an overview of the architecture of the three public benefit guides. It makes clear that it does not form part of those guides, and is not therefore a document to which charity trustees have to have regard when making decisions about their charity.

What it also makes clear is that trustees now only have to have regard to:

- The Guide (PB1) on "Public Benefit: the public benefit requirement" i.e. **the test for whether an organisation is a charity**;
- The Guide (PB2) on "Public Benefit: running a charity" i.e. **the duties of charities trustees to run their charity in accordance with its charitable objects**; and
- The Guide (PB3) on "Public Benefit: reporting" i.e. **the duties trustees have to report on how the trustees have carried out the charity's purposes for the public benefit**.

All previous statutory guidance has been withdrawn. Much of it is likely to be redrafted as guidance, but not guidance to which charity trustees are under a statutory duty to have regard.

For those (especially professionals) interested in the law underpinning this new guidance there is a revised "Analysis of the Law Relating to Public Benefit", which does not form part of anything to which trustees have to have regard.

The guidance, which is written in a clear and simple style, makes it clear that it is not itself the law on public benefit. Rather, it is high level general guidance that reflects the complex law on public benefit that has accumulated over the years and which was exhaustively reviewed in the Decision on the ISC Case.

It also clarifies that "having regard" to these guides in practice means that charity trustees must:

- be aware of the guidance (and its contents);
- take it into account when making any decisions to which it is relevant; and
- if they decide to depart from it, have good reasons for doing so.

The public benefit requirement

PB1 on the public benefit requirement now divides its guidance into two 'aspects' of the requirement and then describes both the 'public aspect' and the 'benefit aspect' in some detail.

The more technical analysis of the previous guidance has been swept away in favour of an explanation of when a purpose can be described as 'beneficial' and how issues of any 'detriment' are to be considered. Equally, when considering the necessary 'public aspect', there is an account of how a charity must benefit the public in general, or a sufficient section of the public, and not give rise to more than incidental personal benefit.

The different rules for poverty charities are set out in Annex A.

Running a charity

PB2 makes it clear that charity trustees must carry out their charity's purposes for the public benefit. This will be relevant when they make decisions about:

- the way in which people can benefit from the charity's charitable purpose; and
- who can benefit.

The latter consideration leads to the thorny issue of the extent to which 'the poor' can benefit from the charity's activities, which is dealt with in a separate Annex C dealing with the topic of charging for services.

The guide is divided up into a number of parts including managing risk of harm (part 4), deciding who benefits (part 5) and managing personal benefits (part 6). But it also underlines the fact that it is for the trustees to decide how to carry out their purposes for the public benefit. Quite separately, further guidance on decision making has also recently been published ("It's Your Decision: charity trustees and decision making".

Reporting

PB3 contains a clear account in part 2 of the reporting requirements in relation to "smaller charities" and "larger charities" and makes it clear (in part 3) that there are no rules about how trustees should report on public benefit.

The new guidance is certainly much less prescriptive, more user-friendly, and contains links to other relevant material on the Commission's website. While there is still some repetition which adds to the length of the documentation, the new guides bring a measure of much needed clarity to the guidance in this area.

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