

# The Independence of Charities from the State - RR7

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## ***About this publication***

1. This publication summarises the Charity Commission's views about the extent to which charities are required by law to be independent of the State. (By "the State" we mean the governmental authorities that make up national and local government.) We have considered this as part of our Review of the Register of Charities. We are very grateful to all those who contributed to the public consultation that led to the formulation of this guidance.

## ***Independence from the State***

2. Charities play an increasingly important role in the supply of services on behalf of local (and, to a lesser extent, national) government. However, for co-operation between charities and the State to be effective, it is important that the framework within which charities operate should be clearly understood. Increased co-operation increases charities' reliance upon the State for funding and, in turn, creates a potential risk to charities' independence. This guidance explains the extent to which legal principles require charities to be independent. It looks at independence in the context of:

- charitable status;
- the way that charities are governed; and
- the way that charities operate.

(Although this publication focuses upon charities' independence from the State, the effect of the legal principles concerned is to require charities to be independent of any other body, not just of governmental authorities.)

### Charitable status

#### *Charities set up by governmental bodies*

3. Charity law is clear that governmental authorities can set up charities. Just because a body has been set up by the State does not prevent it from being a charity. Nor is it a bar to charitable status that the body has been created with a view to taking on a government function. What is important is that the **purposes** for which the new body exists should be exclusively charitable. The mere fact that the body will help a governmental authority to carry out one of its functions does not undermine the body's claim to charitable status. The **motive** of the promoter is irrelevant in deciding whether or not a body is a charity. In practical terms, this means that a charity can be set up to carry out a function of government where there is a charitable purpose that **coincides** with the governmental function.

4. There is therefore no difficulty, in principle, in local authorities establishing charities for the purpose of providing leisure facilities for the public, for example, or providing housing for the poor, and hiring off existing facilities to those charities. In deciding whether or not the new body is a charity, it doesn't matter that the motive of the local authority in setting up the body is to carry out its statutory responsibilities. Nor does it matter that its motive in setting up the body as a charity is to obtain the fiscal and other benefits of charitable status.

#### *The need for independence*

5. However, for a body to be a charity, it must be independent. By this we mean that it must exist in order to carry out its charitable purposes, and not for the purpose of implementing the policies of a governmental authority, or of carrying out the directions of a governmental authority. A body set up to carry out the policies or directions of a governmental authority might engage in much the same sort of **activities** that a charity might undertake. But it would be carrying out those activities in order to further the purposes of a non-charitable body, not to further a charitable purpose. Hence a local authority could not expect simply to convert its leisure department into a charity. Nor could it create as a charity a body whose purpose was to carry out the local authority's leisure policies or to participate in whatever recreational initiatives the local authority decided upon from time to time.

***Bodies with an unstated non-charitable purpose***

6. Of course, a body may be created with a stated purpose that is charitable, but with an unstated purpose that is concerned with giving effect to the wishes and policies of a governmental authority. For example, a body with a stated charitable purpose may have been set up in such a way that:

- it is necessarily dependent upon a governmental authority for funding;
- it receives that funding on terms that enable the governmental authority to make decisions about what services are to be provided and who is to benefit from those services; and
- in making those decisions, the governmental authority is able to pursue its own wishes and policies (without having a duty to act solely in the interests of the new body).

7. It would be difficult to avoid the conclusion that a body of that kind was not really a charity at all. Instead of being set up for the stated charitable purpose, it would exist in fact for the purpose of securing the benefits of charitable status while carrying out the wishes and policies of the governmental authority. In that case, the body would not be a charity because it would not have been established for purposes that are exclusively charitable.

***Characteristics of an independent charity negotiating for government funding***

8. In deciding whether or not a body has been created for an unstated, non-charitable purpose, a useful starting point is to compare the way that the body operates (or is intended to operate) with the way that a charity would be expected to operate. In the case of an independent charity negotiating with a governmental authority for funding:

- the trustees would have a choice about whether or not they accepted funding on the terms proposed by the governmental authority;
- they would take their own legal and financial advice;
- they would draw up their own policies and business plan;
- they would conduct arm's-length negotiations with the governmental authority;
- a trustee who was subject to a conflict of interest would not participate in discussions;
- the funding arrangements would preserve the trustees' fundamental discretions as to the selection of beneficiaries and the provision of services;
- the trustees would not commit themselves simply to giving effect to the policies and wishes of the governmental authority;

- the trustees would not agree to conditions that undermined the confidentiality of their discussions (such as the presence at their meetings of an observer from the governmental authority); and
- the trustees would be free to make their own decisions on matters outside the scope of the funding arrangement.

9. The fewer of these characteristics that a body displayed, the more likely it would be that it had been created in order to promote the local authority's interests and thus for a non-charitable purpose.

10. Of course, depending upon the circumstances, an alternative conclusion might be that the body had been created for exclusively charitable purposes but was not operating properly. In that event, while recognising the body's charitable status, we would need to take steps to secure its proper administration.

### **Governance of charities**

#### ***Continuing need for independence***

11. So far as the governance of charities is concerned, charities are required to be independent in the sense that anyone who exercises powers in relation to the governance of a charity is bound to act solely in the interests of the charity. This is not just a requirement at the point when a body is registered as a charity. Charities must remain independent throughout their existence.

#### ***The duty of trustees***

12. In carrying out his or her responsibilities, a trustee must act solely in the interests of the charity. A trustee is not a delegate of the body that appoints him or her. It is no part of a trustee's function to represent or promote the interests of a third party, whether that third party is the body that has appointed him or her, a funding body, or a body of which the trustee is a member or employee or in which he or she has some other interest.

13. It follows that a funding body cannot properly insist upon appointing a trustee to protect its interest as a condition of providing funding. The legitimate concern of governmental authorities that public funds for which they are responsible should be:

- applied for the purposes for which they were given;
- properly accounted for; and
- used in such a way as to give value-for-money must therefore be met by other means, such as monitoring and liaison.

#### ***The duty of third parties***

14. Where a governmental authority has been given powers under a charity's governing document, it is bound to exercise those powers solely in the interests of the charity. A power to appoint trustees, for example, must be exercised so as to select the individuals best suited (in the opinion of the appointer) to act as trustees of the charity. If a governmental authority could

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exercise a power in the administration of a body for its own benefit, the body in question would not be a charity, since it would exist in part for the benefit of the governmental authority.

### *Conflict of interest*

15. Consistently with the duty to act solely in the interests of the charity, a trustee is bound to avoid placing himself or herself in a position where there is a conflict between duty to the charity and personal interest. Where, for example, there is a contractual relationship between a charity and a local authority, a trustee who is a councillor or officer of the local authority is placed in a position of conflict between duty to the charity and loyalty to the local authority whenever the trustees discuss matters relating to that contractual relationship (including issues such as the proposed terms of the contract, whether the contract is being performed properly and its enforcement or termination). Both the charity and the local authority have an interest in securing the terms most favourable to itself. Even though a councillor has no general duty to further the interests of the local authority, membership of the local authority gives him or her an incentive to promote the interests of the local authority and hence creates a conflict.

16. It may be possible to deal with a conflict of interest by requiring the conflicted individual to withdraw from discussion of (and, of course, to refrain from voting upon) the matter that gives rise to the conflict of interest. On the other hand, in the case of a substantial and recurring conflict of interest, it may be necessary in the interests of the charity for the individual in question to stand down altogether in favour of someone not subject to conflict of interest. Where a trustee benefits personally as a result of a conflict of interest, he or she may not be allowed to retain that benefit in the absence of express authorisation in the charity's governing document or from the Commission.

17. Although conflict of interest is generally a problem of governance, in some circumstances it may be relevant to the question of whether or not a body really is a charity at all. The fact that a body's governing document authorises trustees to take part in decisions in which they have a conflict of interest may be a factor pointing to a non-charitable purpose (see paragraph 8 above).

### *Confidentiality*

18. For a charity to function as an independent body, the trustees must be able to discuss its business in confidence. Provisions in a body's governing document, or in funding agreements, that tend to inhibit confidential discussion by the trustees may show that the body is not intended to be independent. Examples of provisions of this kind include:

- provisions expressly permitting trustees to be present despite a conflict of interest;
- requirements that trustees who are members or officers of the local authority must be present in order to found a quorum; **and**

- provisions entitling the local authority to send an observer to all trustee meetings.

19. Whether or not they undermine a body's claim to charitable status, provisions of this kind would certainly be inconsistent with independent governance.

### **Operation of charities**

#### ***Funding agreements***

20. Charities are required to be independent in the way that they operate. Charity trustees can enter into a funding agreement with a governmental authority only if:

- the agreement does not require the charity simply to implement the policies, or carry out a statutory duty, of the governmental authority;
- the agreement does not involve a surrender of the trustees' discretions to the governmental authority; and
- the terms of the agreement coincide with the way that the trustees want to exercise their discretions.

#### ***The funding authority's policies***

21. It would be unrealistic to expect a charity to be given an entirely free hand given that funding authorities have a responsibility to protect the interests of taxpayers and service users. Moreover, it has to be recognised that in practice funding authorities generally enjoy a strong bargaining position. However, simply carrying out the policies, wishes or statutory duties of a governmental authority is plainly not the same as carrying out a charitable purpose. Hence trustees cannot agree to accept funding on terms that require them expressly:

- to implement particular policies of the local authority; or
- to comply with decisions that are made from time to time by the local authority; or
- to pursue the objectives of the local authority; or
- to discharge the statutory duties of the local authority.

#### ***Trustees' discretion***

22. The trustees of a charity are bound to exercise their own discretion in deciding who will benefit from the charity, or precisely what facilities or services should be made available, or when and on what terms the public (or particular sections of the public) should be able to use the charity's facilities or services. Trustees can surrender their discretion to make those decisions only if they have power to delegate them (for example, under the charity's governing document). Where trustees are authorised to delegate, the person who makes the decision has the same duty as the trustees to take into account only considerations that are relevant to the pursuit of the charity's purpose.

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23. In the absence of power to delegate, trustees cannot agree to allow a third party, such as a governmental authority, to decide who is to benefit and in what way. That would be so even if the governmental authority's rights of selection were restricted to persons who fell within the charity's beneficiary class. (In the absence of any duty to act solely in furtherance of the charitable purposes of the charity, it would be open to the governmental authority to apply its own policies and achieve its own wishes in making its selection).

24. However, although it would not be open to the trustees of an independent charity to surrender their discretion to a funding body in that way, it is possible for trustees to accept funding from a governmental authority on terms that are quite prescriptive. There are some decisions which are made once-and-for-all at the outset of a funding agreement. Depending upon the type of charity involved, decisions of that kind may relate to matters such as levels of charging, hours of opening, facilities to be provided, forms of tenancy and standards of service. If trustees are satisfied that the terms negotiated coincide sufficiently with the way that they want to pursue their charitable purposes, they can properly accept funding on those terms. In these circumstances, there would be no surrender of discretion.

25. However, in the case of continuing decisions (such as the selection of individuals for benefit), to allow the decision to be made by an individual or body with no fiduciary duty to the charity amounts to a surrender of discretion.

26. Trustees must not only avoid surrendering their discretion without proper authority. They must also avoid fettering their discretion (except where the interests of the charity require them to do so). Trustees who are independent are less likely to be able to agree to highly detailed conditions which are binding for lengthy periods, than conditions which set out broad principles or outcomes and allow the trustees a degree of latitude in how they achieve those outcomes.

27. Lack of independence in areas which are either wholly outside the scope of the activities funded by the local authority, or merely peripheral to those activities, would be problematic for independently-established charities considering contracting with the local authority. Examples would include restrictions on the trustees' freedom to carry out other charitable activity or to solicit funds from other sources, to campaign or to employ, train, discipline and dismiss staff; and obligations to provide detailed information going far beyond what the local authority might reasonably require for monitoring purposes.

28. Depending upon the circumstances, an organisation set up with the intention that the members of its governing body should exercise their discretions in a particular way may well not be a charity (see paragraph 8 above). In the case of an existing charity, on the other hand, failure by the trustees to exercise their discretions properly (or at all) might well amount to misconduct or mismanagement.

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## Further information

29. More information about some of the ways in which local authorities may be involved in how charities are run and in what they do can be found in our publication **CC29 - Charities and Local Authorities** and in our Operational Guidance (**OG56 - Local Authorities and Trustees**), available on our website at [www.charitycommission.gov.uk](http://www.charitycommission.gov.uk)

30. Advice and guidance to trustees and staff of charities thinking of entering into contracts with public bodies to provide services on behalf of those public bodies in return for payment can be found in our publication **CC37 - Charities and Public Service Delivery**. Further information can also be found in **RS15 - Stand and deliver: The future of charities delivering public services**.

31. Guidance about some of the issues that may need to be considered in setting up a charity can be found in our publication **CC21 - Registering as a Charity**. For more information please contact Charity Commission Direct on 0845 300 0218.