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SCOTTISH CHARITY LAW REFORM: AN AGENDA FOR COHERENCE

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Introduction

These are exciting times in Scotland, especially for lawyers. A devolved Scottish Parliament will be making new law as we enter the coming millennium. After three centuries of looking to Westminster for scarce parliamentary time, we Scots will again have our own legislators - eager, we hope, to tackle a long backlog of non-controversial law reform. It has even been suggested that if the new Parliament is too eager it will soon run out of things to do, but if that does happen then surely we Scots lawyers will have failed the new system. A vast and exciting project lies before us - that of returning coherence to the areas of our law which, no doubt inevitably, have received insufficient attention from a post-Union legislature with largely Anglocentric priorities.[2] Certainly in the field of Scottish charity law there is much to be done.

The yoke has not, of course, been thrown off completely. Westminster is to retain control of a crucial range of "reserved matters". Perhaps the most significant of these for the Scots charity lawyer is taxation. The Scottish Parliament will have power to vary the basic rate of income tax by three per cent either way and to regulate local authority taxation, but the issue of "charity" reliefs from non-local

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2 It is worth remembering that the Treaty of Union of 1707 and the legislation which gave it effect "extinguished the Parliaments of Scotland and England and replaced them by a new Parliament" of Great Britain: *MacCormick v Lord Advocate* [1953] SC 396, per Lord President Cooper at 411. Not surprisingly, the "new" Westminster Parliament has given more time to the legislative needs of the larger of the partners to the Union.

taxes will continue to be settled at United Kingdom level.[3] Trade and industry are to be reserved, including control of "business associations", whether or not established for profit, but the "creation, operation, regulation and dissolution of...charities" are specifically excepted from the reservation;[4] and Scots private law may be modified so long as reserved and unreserved matters are affected consistently. Would-be reformers must therefore tailor their projects with some care to fit what the new Scottish Parliament can actually do. The purpose of this article is to make suggestions for Scottish charity law reform which could be given effect by the new Parliament in Edinburgh with the minimum need for additional legislation from Westminster.

Interest in Scottish charity law reform is not, of course, a purely devolution - related phenomenon. The establishment of a Scottish Parliament will simply enhance the possibility of change in an area which, as in England and Wales, has been the subject of anxiety and debate for some time. The Woodfield Report of 1987, concluding that it would be "unsafe" to leave things as they were in Scotland, gave rise to new charities legislation[5] whose effectiveness is now itself under scrutiny in research commissioned by the Scottish Office in early 1997.[6] The Commission on the Future of the Voluntary Sector in Scotland, set up in 1995, included recommendations on the reform of charity law in its report (the "Kemp Report") published some 17 months later.[7] This article aims to contribute to the debate by offering a brief theoretical outline of the existing Scottish "charities" system, by identifying its main strengths and weaknesses - in particular its failures of coherence - and by suggesting an agenda for post-devolution reform. The agenda is deliberately limited: it is an "agenda for coherence", concerned less with the day-to-day mechanics of the system

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3 Scotland Act 1998, s.73; s.29(2)(b), s.30(1) and Sched 5, Part II, Section AI.

4 Scotland Act, Sched. 5, Part II, section CI and s.29(1); but subject to the power of the Secretary of State for Scotland to intervene if he considers the modifications would adversely affect the operation of the law on reserved matters; see s.35 of the Act.

5 The Woodfield Report, *Efficiency Scrutiny of the Supervision of Charities,* paras 3 and 144. The report gave rise, via Scottish Office consultation and framework documents, to Part I of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990.

6 The research is being carried out by the Charity Law Research Unit at the University of Dundee under the direction of Dr Christine Barker. The writer is a member of the Unit but it is emphasised that this article has been prepared independently of the research and that the suggestions made for reform are those of the writer, not the Unit.

7 The Commission, set up with funding from the Scottish Council for Voluntary Organisations, was chaired by Mr Arnold Kemp, formerly editor of *The Herald*. The Kemp Report is the Scottish equivalent of the Deakin Report.

than with its underlying structure. Its main object is to address the structural deficiencies of the present system which arise from a mismatch between its legislative elements and its foundation in Scots common law.

Preliminaries

Two preliminary points need to be made. The first is that, while it is normal to talk about the Scottish "charities" system, that is not a fully accurate description. The system is a "public benefit" system in a much wider sense. As will be shown later in the article, the English definition of charity plays a significant part in the system, but not to the exclusion of the indigenous Scottish concept of public benefit enshrined in the Scots law of public trusts.[8] In particular, the range of public benefit activities allowed for by the Scottish system is not restricted to "uses" derived from the Charitable Uses Act 1601.

The second preliminary point is to suggest that there are certain policy objectives which any public benefit system - including any "charity" system based on the 1601 Act - must seek to meet. These are a matter of common sense as much as law but can be used as criteria against which any specific set of legal provisions can be judged. It is suggested that any policy-maker's minimum expectation of a public benefit system must be:

1. That it *facilitates* the formation and operation by private individuals of organisations intended to benefit the public ("public benefit organisations" or "PBOs");

2. That it *promotes* the formation and operation of PBOs: promotion goes a stage further than facilitation by actively encouraging the work of PBOs - for instance by means of state subsidies, direct or indirect (typically by way of tax relief), or by provision of a benign framework for public giving;

3. That it *regulates* the formation and operation of PBOs: regulation is distinct from, though often associated with, the first two objectives - comparatively unsophisticated systems exist in which the emphasis is on facilitation and promotion, and which leave the good conduct of PBOs almost entirely to the

8 *Wink's Executors v Tallent* [1947] SC 475, per Lord President Cooper at 476.

organisations themselves.[9]

These objectives are offered as common-sense criteria against which the strengths and weaknesses of the Scottish - or any - system can be measured.

Existing Public Benefit System in Scotland

The existing public benefit system in Scotland can be presented as operating at three distinct levels. Such a presentation may give the impression of a more or less coherent, three-tiered whole, but misleadingly implies the existence of a grand design. In reality the system is made up of an assortment of legislative provisions - Part VI of the Education (Scotland) Act 1980, section 119 of the Civic Government (Scotland) Act 1982, Part I of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990[10] - superimposed on the common law of Scotland with minimal provision for integration. The resulting three "tiers" of the system are as follows:

1. *Tier 1:* the "Public Benefit" tier: this tier is defined by the Scots common law concept of "public benefit" and facilitates and regulates the formation and operation - as trusts and unincorporated associations - of PBOs whose purposes or objects confer benefit on the public in any way;

2. *Tier 2:* the "Charitable, Benevolent or Philanthropic" tier: this tier is defined by the statutory expression[11] "charitable, benevolent or philanthropic" and promotes the operation of PBOs by permitting (and regulating) fund-raising from the public for purposes which fall within the expression "charitable, benevolent or philanthropic";

3. *Tier 3:* the "Charitable" tier: this tier is defined by the expression "charitable purposes" in its technical meaning according to English law; the tier facilitates, promotes and regulates the operation of PBOs whose purposes or objects fall within the English definition of "charitable" by (1) providing statutory mechanisms for reorganisation, (2) offering state subsidy

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9 e.g. the charities system in the Republic of Ireland, see Kidd, *The Voluntary Sector in the European Union: the Legal and Fiscal Framework* (1996), p. 41. See also G St J Moore, "The Law of Fundraising: Time for Change", (1997) 15 ILT 154. Mr Moore has generously allowed the writer to see in draft a further article proposing reform of Irish charity regulation generally, to appear shortly in *Irish Law Times*.

10 Referred to in the remainder of this article as "the 1980 Act", "the 1982 Act" and "the 1990 Act".

11 The 1982 Act, s.119(16).

through tax relief, and (3) imposing a statutory regime of regulation.

Tier 1: Public Benefit

Definition: The first tier of the system is a creation of Scots common law. It is defined by the concept of public benefit established by the Scottish courts as part of the law of public trusts.[12] A public trust is one constituted for the benefit of the public or of a section of the public.[13] The objects of the trust must be certain, but there are no restrictions on the nature of the "public benefit" other than that it must not be illegal, contrary to public policy, or *contra bonos mores*.[14] In principle, therefore, the range of possible benefit is enormously wide, and capable of including any future forms of "benefit" which may be thrown up by social change. This is because, by contrast with the English position, there is no requirement for new forms of public benefit to meet a restrictive set of criteria such as those imposed by the technical definition of "charitable". There is no equivalent in Scots common law (it is worth repeating) of the requirement in English law that "charitable" trust purposes must relate back to the "uses" of the 1601 Act - whether by analogy or by falling generally within the spirit and intendment of the preamble to the Act.

By way of example, a trust for the provision of sporting facilities for the inhabitants of a named town is a valid public trust in Scots law simply because it benefits a defined section of the public.[15] There is no additional requirement to link the facilities with the advancement of education[16] or otherwise to bring them within the

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12 In Scotland the trust is a creature of the common law and does not depend on a distinction between law and equity.

13 The classic statement of the law is still Lord McLaren's in *Wills and Succession* (3rd ed., 1894), p. 917, adopted by Lord Skerrington in *Anderson's Trustees v Scott* [1914] SC 942, at 955, and more recently by Lord Jauncey in *Russell's Executor v Balden* [1989] SLT 177, at 179. See also Wilson and Duncan, *Trusts, Trustees and Executors,* (2nd ed., 1995), pp. 195 et seq.

14 These requirements apply to any Scottish trust, public or private, and are set out in another semi-institutional Scottish textbook, Mackenzie Stuart, *The Law of Trusts* (1932) pp. 73 et *seq*. See also, with particular reference to public trusts, *Aitken's Trustees v Aitken,* 1927 SC 374, per Lord Sands at 381

15 *Russell's Executor v Balden supra*. Cf. *Re Nottage* [1895] 2 Ch 649.

16 Cf. *IRC v McMullen*, [1981] AC I.

boundaries of "charity", even as extended by the Recreational Charities Act 1958.[17] A Scottish "public" purpose, therefore, is not unlike an English "philanthropic" purpose.[18] It benefits the public but need not be "charitable" in any restrictive sense.

Facilitation: *Tier 1* facilitates the formation and operation by private individuals of trusts and unincorporated associations devoted to public benefit. It provides the criteria for validation of public trusts on constitution, and facilitates the reorganisation of redundant public trusts through the inherent *cy-près* jurisdiction of the Court of Session, now supplemented by the 1990 Act.[19] *Tier 1* also enables unincorporated associations formed with "public" objects to hold property in pursuance of their objects. A distinction is made in Scots law between an association formed for the benefit of its members, whose property is held in trust for the members and distributed on dissolution among the members who remain,[20] and an association formed for public benefit, whose property is held in trust for its public objects and on dissolution falls to be applied *cy-près* for public benefit if no default provision has been made.[21] The property of a "public association" is held, in effect, in a public trust.

Promotion: There are no mechanisms specific to *Tier 1* which go beyond facilitation to promotion of PBOs, whether by state-funded incentives or a state-supervised structure for inviting funding from the public at large.

Regulation: The mechanisms of regulation applied at *Tier 1* are inseparable from its facilitatory mechanisms and are equally a function of trust law. They depend on the plenary jurisdiction exercised by the Court of Session over all trusts, public and

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17 *Guild v IRC* [1992] 2 AC 310. *Russell,* supra, and *Guild* dealt with the same will, in which the testator left the residue of his estate to "the Town Council of North Berwick for the use in connection with the sports centre in North Berwick or some similar purpose in connection with sport"; *Russell* established the existence of a valid public trust and *Guild* that the bequest was "charitable" (in the English sense) for tax purposes, by virtue of the 1958 Act.

18 *Anderson's Trustees v Scott*, supra: see Lord Skerrington's reference at 956 to *Re Macduff* [1896] 2 Ch 45.

19 Sections 9, 10 and 11. The English equivalents are sections 13, 74 and 75 of the Charities Act 1993.

20 *Gardner v McLintock,* (1904) 11 SLT 654.

21 *Anderson's Trustees v Scott,* supra*:* heritable property held by trustees for a religious association fell to be applied *cy-près* on dissolution of the association.

private.[22] The controls are reminiscent of the regime exercised by the Court of Chancery over English charitable trusts before the advent of the Charity Commissioners in 1853. The Lord Advocate represents the public interest in (broadly speaking) the same way as the Attorney-General does in England and Wales. Members of the public who can show an interest as potential beneficiaries may raise an *actio popularis* against the trustees.[23] The Court may supervise the trustees and enforce the trust.

Strengths and weaknesses: The principal strength of *Tier 1* is its inclusiveness. As a matter of policy, it seems desirable to facilitate PBOs to carry out the widest possible range of publicly beneficial activities. Its principal weakness is that it fails to offer incorporation and limited liability as part of the system. Private individuals wishing to set up PBOs with these advantages have been forced to borrow forms from the world of commerce, most notably the company limited by guarantee. The result is a significant weakness in the regulatory effectiveness of *Tier 1*: while it is perfectly possible in Scotland to constitute a PBO as a company limited by guarantee - by incorporating it with "public" objects analogous to the purposes of a public trust - such a body lies, by definition, outside the supervisory jurisdiction of the Court of Session over public trusts.[24] In other words, a PBO formed otherwise than as a trust or unincorporated association lies - unless a trust can be implied - entirely beyond the reach of the "public benefit" controls of *Tier 1*. A further weakness is that the regulatory mechanisms which do apply at *Tier 1* to public trusts and associations are inadequate in themselves. There is no requirement, for instance, for public trusts and associations to register as such.[25] These weaknesses are only partly remedied at the remaining tiers of the system.

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22 *Income Tax Special Commissioners v Pemsel* [1891] AC 531 (HL), per Lord Watson at 560.

23 *Andrews v Ewart's Trustees,* (1886) 13 R 69, per Lord Watson at 73. There is some dispute as to whether *'actio popularis'* is the correct name for such an action but it is clear that the right of action exists, whatever its proper name. See Wilson and Duncan, *op.cit.*, p. 196 Cf. Charities Act 1993 s.33.

24 The point does not seem to have been addressed directly by the Scottish courts. In *Glasgow Magdalene Institution, Ptnrs.*, 1964 SLT (Notes) 53, the Court of Session exercised jurisdiction over a body incorporated by Royal Charter for the purpose of authorising a *cy-près* scheme only on the basis that the Privy Council Office had declined to intervene and consented to the court's doing so. The basis of jurisdiction was, however, the court's *nobile officium* - enabling it to provide a remedy where none otherwise exists - and not, apparently, its jurisdiction over public trusts. Cf. *Construction Industry Training Board v A-G.* [1973] Ch 173.

25 Many, but not all, will appear on the Inland Revenue's index of "Scottish charities" under the 1990 Act.

Tier 2: Charitable, Benevolent, Philanthropic

Definition: The second tier of the Scottish system is the product of statute. The relevant provisions are section 119 of the 1982 Act and the regulations made by the Secretary of State for Scotland under that Act:[26] *Tier 2* permits, subject to regulation, the collection of money from the public for "charitable, benevolent or philanthropic purposes", whether or not they are "charitable within the meaning of any rule of law".[27]

How are the purposes covered by this phrase different from the purposes covered by the concept of "public benefit" at *Tier 1*? The short answer is that "charitable, benevolent or philanthropic" purposes are broadly similar to "public" purposes but that there are significant differences of detail. The position, briefly, seems to be as follows: "charitable" in its Scots law sense is included within "public"[28]; so also, in principle, is "charitable" in its English law sense, in that an English charitable purpose by definition confers benefit on the public;[29] on the other hand, "charitable" used other than "within the meaning of any rule of law" (i.e., in its "popular meaning"), while far from easy to define,[30] seems capable of including "private" charitable purposes aimed at benefiting designated individuals who do not constitute a section of the public - so that "charitable" in this sense cannot be wholly included in "public".[31] "Benevolent" might also describe "private" benefit to a designated

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26 The Public Charitable Collections (Scotland) Regulations 1984, as amended by the Public Charitable Collections (Scotland) Amendment Regulations 1988.

27 Section 119(6) of the 1982 Act.

28 McLaren, *Wills and Succession* (3rd ed., 1894), p 917. For the meaning of "charitable" in Scots law see *Income Tax Special Commissioners v Pemsel,* supra, per Lord Watson at 556 et seq., still the most authoritative discussion available.

29 An English charitable trust will normally, by definition, benefit a section of the public. The exception to the principle is charitable trusts for poor relations or employees who do not amount to a section of the public: *Dingle v Turner* [1972] 1 All ER 878.

30 *Income Tax Special Commissioners v Pemsel, supra*, per Lord Watson at 558, disapproving the efforts of the Court of Session in *Baird's Trustees v Lord Advocate,* (1888) 15 R 682 to adopt a "popular meaning" of "charity".

31 This is implicitly recognised in the poor relations and poor employees cases.

individual and to that extent fall outside the range of "public".[32] As previously noted, "philanthropic" and "public" have much in common, but "philanthropic" may also cover purposes beneficial to humankind at large which might not be treated by the courts as "public" for reasons of policy.[33]

While, therefore, *Tiers 1* and *2* cover similar ground, the match is far from exact. For example, a public collection for, say, a sick child, or a small group of designated individuals struck by a disaster, would be covered by *Tier 2* as "benevolent", but a trust or association set up to help the same people would not be covered by *Tier 1* because not "public" in character. In the same way, an unincorporated association set up to campaign for a change in the law might be excluded from *Tier 1* on public policy grounds,[34] but still be included at *Tier 2* as "philanthropic".[35] The discrepancy between the two tiers can be explained, no doubt, by the fact that the statutory phrase "charitable, benevolent or philanthropic" originated in United Kingdom public order legislation, not in a coherently planned development of the Scottish public benefit system as such. The legislators, for that reason, seem to have made no particular effort to tie the phrase in with the existing Scots law of public trusts.[36]

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32 *Re Macduff,* supra, per Stirling J at 457. See also discussion of the statutory phrase as it appears in Part II of the Charities Act 1992 in Middleton and Lloyd, *The Charities Act Handbook* Jordans, (1996), p. 77 *et seq.*

33 All the arguments of principle on the public benefit element of "charitable" rehearsed by Slade J in *McGovern v A-G* [1982] 321 seem equally applicable in Scotland.

34 Because it is not for the courts but the legislature to decide whether or not the change being campaigned for would be beneficial to the public: *McGovern v Att-Gen,* supra.

35 Although "private" for the purposes of Tier I, the body would, it is submitted, be able to raise funds by public collections.

36 The 1982 Act provisions replaced, as part of a "Code of Civic Government for Scotland" (per consultation paper), regulations made under section 5(3) of the Police, Factories, etc (Miscellaneous Provisions) Act 1916 and the House to House Collections Act 1939, both UK statutes formerly applicable in Scotland. The phrase "charitable, benevolent or philanthropic" was retained from the earlier legislation. See *Scottish Current Law Statutes Annotated* (1982), ch. 45.4-7. Regulation of public collections has since been recognised as belonging to the English "public benefit" system by Part III of the Charities Act 1992, which (when and if brought into force) will replace the provisions of the 1916 and 1939 Acts in England and Wales.

Facilitation: *Tier 2* is concerned with promotion, rather than facilitation.

Promotion: *Tier 2* promotes the operation of PBOs by allowing them to raise funds from the public in support of their public benefit activities. Public collections - that is, collections of money taken in a public place or by means of visits from place to place - are permitted, subject to regulation. What this amounts to in policy terms is a waiver of the normal public order restriction on the solicitation of money in public (i.e. begging) in return for the public benefit pay-back expected from a PBO with objects which fall within the defined range. On this analysis, the authorisation of "charitable" or "benevolent" collections for the benefit of individuals not amounting to a "section of the public" is anomalous.

Regulation. The mechanisms of regulation at *Tier 2* are placed to a large extent in the hands of the local authorities. It is an offence to solicit money from the public by public collections without permission from the relevant local authority. An appeal against refusal of permission by a local authority lies to the Sheriff Court. The Secretary of State may exempt a person who pursues charitable, benevolent or philanthropic purposes throughout the whole or a substantial part of Scotland from obtaining local authority permissions, subject to giving due notice of any forthcoming collection. Collecting boxes and sealed envelopes must be opened in controlled conditions and their contents accounted for by submission of accounts in specified to form to the local authority (or in the case of an exempted person to the Secretary of State) and by publication of a summary.

An important difference between the regulatory controls of *Tiers 1* and *2* is that the controls of *Tier 2* are directed primarily at individuals, not PBOs. The responsibilities laid on the "organiser" of a permitted collection, and on agents and collectors acting on the organiser's behalf, are laid on each person as an individual. An organiser need not necessarily be a trustee or other official, or employee, or formally appointed agent, of the PBO for which funds are being collected.

Strengths and weaknesses. The main strength of *Tier 2*, is its inclusiveness: it promotes the work of PBOs over a wide range of activities by harnessing the natural generosity of the public. It suffers from two important weaknesses. The first is as its poor dovetailing with *Tiers 1* and *3*. *Tier 2* regulates the process of collection, but only to the point at which the proceeds are handed over to the recipient organisation or organisations.[37] The difficulty is that money quite properly collected for "charitable, benevolent or philanthropic" purposes at *Tier 2* can be handed over

37 The 1984 Regulations (11(3)(d)) envisages that proceeds should be paid to "funds" or "organisations", but a recipient need not be a PBO: a "benevolent" collection could pass to a private trust.

to bodies which may be (1) inadequately regulated at *Tier 1* because formed otherwise than as a public trust or association and (2) inadequately regulated at *Tier 3* because not falling within the English definition of "charitable".[38] The danger is that once the proceeds of a public collection have passed into the hands of such a body they lie beyond the scope of the Scottish public benefit system altogether.

The second major weakness of *Tier 2* is that the only form of fund-raising it regulates is traditional public collections, either in public places or from house to house. There are no statutory provisions in Scotland equivalent to Part II of the Charities Act 1992 which deal with fund-raising through commercial participators and professional fund-raisers.

Tier 3: Charitable

Definition: *Tier 3* is defined by the expression "charitable purposes" in its technical meaning according to English law. The English definition is imported into the Scottish system by a combination of statute and the House of Lords decision in *Income Tax Special Purposes Commission v Pemsel.*[39] Both the 1980 Act and the 1990 Act come into play at this tier, as well as the relevant taxation statutes.[40] The 1980 Act makes provision for reorganisation of "endowments" and defines an "endowment" as "any property, heritable or moveable, dedicated to charitable purposes". The term "charitable purposes" is to be construed in the same way as in income tax legislation.[41] The 1990 Act defines a "Scottish charity" as a body to which intimation has been given by the Inland Revenue "that relief will be due under section 505 of the Income and Corporation Taxes Act 1988 in respect of income of the body which is applicable or applied to charitable purposes only".[42] *Pemsel* established that the expression "charitable" appearing in a United Kingdom taxation

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38 An example would be a PBO formed as a company limited by guarantee to pursue objects which were public/philanthropic, but not "charitable" in the English sense. Such a body would escape the trust-based controls of *Tier 1* by virtue of its form, and the "charity" based controls of *Tier 3* by virtue of its non-charitable purposes.

39 [1891] AC 531 (HL).

40 Income and Corporation Taxes Act 1988, Taxation of Chargeable Gains Act 1992, Inheritance Tax Act 1984, Finance Act 1982 (Stamp Duty), Local Government (Financial Provisions) (Scotland) Act 1962.

41 Section 122(1).

42 Section 1(7).

statute is to be read in its technical meaning in English law.[43]

How are "charitable" purposes different from "public" purposes at *Tier 1* and "charitable, benevolent or philanthropic" purposes at *Tier 2*? The short answer is that charitable purposes cover a narrower range. As noted earlier, public purposes include (in principle) all charitable purposes, but there are also public purposes which are not charitable in the technical English sense.[44] So also the expression "charitable, benevolent or philanthropic" manifestly includes but extends beyond the term "charitable" on its own. In particular, as also pointed out above, the wider phrase is capable of including purposes which fail to meet the public benefit requirement of "charitable" in its technical sense - either because they benefit persons not amounting to a section of the public, or because they confer "public benefit" of a kind which, though "philanthropic", is not enforced by the courts for reasons of policy.

The discrepancy with *Tiers 1* and *2* can be explained in general terms by the very great practical significance in Scotland of the tax reliefs associated with the English definition of "charitable". For most decision-makers in the Scottish voluntary sector, this is the definition which counts. While the Court of Session has been vigilant, the temptation is always there - even for Scots lawyers - to allow the English definition to obscure, if not supplant altogether, the native Scottish concept of public benefit.[45] In Part VI of the 1980 Act - which favours the Anglified "endowment" and "charitable purposes" over the indigenous law - the legislators seem to have succumbed to the temptation.

In the 1990 Act, a nod at least is bestowed on the underlying Scots law: three sections deal specifically with the reorganisation of public trusts. The scope of the remainder of Part I, however, is determined instead by the English definition. The reason in the case of this Act is almost certainly pragmatic: given that no definitive register of PBOs (however defined) existed in Scotland at the time of the Woodfield Report, the obvious (and inexpensive) substitute was the Inland Revenue's internal record (or "index") of bodies recognised as eligible for "charitable" tax relief.[46]

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43 [1891] AC 531 (HL), per Lord McNaghten at 587. For the application of *Pemsel* in Scotland see *Inland Revenue v City of Glasgow Police Athletic Association* [1953] SC (HL) 13, per Lord Normand at 21.

44 See above and *Anderson's Trustees v Scott,* supra.

45 See: *Wink's Executors v Tallent,* supra, *Russell's Executor v Balden,* supra.

46 Scottish Home and Health Department, *Charities in Scotland A Framework for Supervision,* (1989) para 2.1

***Facilitation*:** Part VI of the 1980 Act deals principally with the reorganisation of educational endowments, and is perhaps best seen as part of the Scottish education system rather than of the public benefit system. Sections 108 and 108A of Part VI, however, contain provision for the reorganisation of *non*-educational endowments.[47] The Court of Session may approve a reorganisation in certain circumstances on the petition of the governing body of the endowment. The Lord Advocate may also petition the court for a reorganisation. The powers of the court to approve a reorganisation are not restricted to endowments held through the medium of a public trust.[48]

Promotion: Section 505 of ICTA 1988, and the parallel relieving provisions for the other taxes, promote PBOs by offering state subsidy in the form of "charitable" tax relief. The reliefs are available to qualifying Scottish PBOs as to PBOs in the rest of the United Kingdom.

Regulation: The 1980 Act contains some (limited) provision for regulation of educational (but not *non*-educational) endowments. Part I of the 1990 Act, on the other hand, introduced an entirely new regime of supervision for "Scottish charities" (from which educational endowments are largely exempted).[49] The new regime has certain parallels with its English equivalent, but any suggestion that the two are truly comparable should be treated with care. Part I of the 1990 Act contains in total only fifteen sections, the Charities Act 1993 exactly a hundred.[50] As is well known, there never have been and there are still no Charity Commissioners in Scotland. Such of the Commissioners' functions as do have an equivalent under the 1990 Act are shared out among a number of institutions: the Inland Revenue "recognises" Scottish charities by reference to entitlement to tax relief; the Lord Advocate (in practice acting through the Scottish Charities Office) has powers of investigation and (to a limited extent) of intervention; the Court of Session has new powers of intervention (supplementing those of the common law and likewise exercisable at the instance of the Lord Advocate) to forestall misconduct and mismanagement and to protect charity assets; the "Scottish charities nominee" performs functions broadly similar to those of the Charity Commissioners in bringing funds lying dormant in charity bank accounts back into use for public benefit, and the Secretary of State exercises

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47 An oddity, perhaps, in an Education Act, but a not untypical example of Westminster law-making for Scotland.

48 Because of the definition of "endowment" the court's statutory powers will be effective only in respect of public trusts whose purposes are "charitable".

49 The 1990 Act, s.15(9).

50 The unconsolidated sections of the Charities Act 1992 amount to another 22.

a variety of regulation - making powers.

Strengths and weaknesses: The strengths of *Tier 3* are as follows: first, it provides statutory mechanisms for the reorganisation of "endowments" which apply regardless of the legal form through which an endowment is held - in this respect remedying one of the deficiencies of *Tier 1*. Secondly, it promotes a wide range of publicly beneficial activities by indirect subsidy through the tax system. Thirdly, it imposes a statutory regime of supervision of PBOs which goes far beyond the antiquated common law regime of *Tier 1*, and in particular is effective over Scottish charities irrespective of legal form. There is much to admire in the 1990 Act: in a few short sections, it makes use of existing Scottish institutions - and minimal extra resources - to set up a respectable degree of public accountability for PBOs in Scotland where almost none existed before.

The main weaknesses of *Tier 3* are as follows: first, *Tier 3* does not fit cohesively with *Tiers 1* and *2*. *Tier 3* is defined by reference to the technical term "charitable", which covers a narrower range than either "public benefit" or "charitable, benevolent or philanthropic". The result is that the facilitatory and (more importantly) regulatory mechanisms of *Tier 3* are effective over only a proportion of the PBOs which (1) operate as public trusts and associations at *Tier 1* and/or (2) receive money from the public at *Tier 2*. This deficiency is aggravated by the fact that the regulatory mechanisms of the 1990 Act cover only "charitable" PBOs which have in fact applied for and received intimation from the Inland Revenue of their eligibility for tax relief. Such PBOs may, in effect, elect to escape the new supervisory regime for Scottish charities by foregoing tax relief.[51]

Secondly, the regulatory regime introduced by the 1990 Act may be insufficiently rigorous in itself. There are gaps which may surprise an English reader: for instance, there is still no definitive register of Scottish charities (let alone of PBOs which are not technically charitable), the Inland Revenue's "index" amounting to nothing more than a list (with addresses and the date of the last contact) of bodies which have been recognised at some time in the past as entitled to tax relief - with no provision for systematic updating; there is no requirement for submission of annual accounts to any central institution for convenient inspection by the public, there are no restrictions (other than those imposed in a body's founding document) on dispositions of charity land; there is no control of the use of charity names

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51 There is some attempt to plug this gap by providing that a body which is neither a Scottish charity - not having been recognised by the Inland Revenue - nor an English charity may not "represent itself or hold itself out as a charity" - see sections 2, 6 and 7 of the 1990 Act. The question must also be asked whether educational endowments, which are by definition "charitable", are adequately regulated under the 1980 Act.

(except, for charitable companies, as a function of the general control of company names exerted by the Registrar of Companies).

Thirdly, the promotion of Scottish PBOs through tax relief is tied, as in the rest of the United Kingdom, to the notoriously complex[52] question of what is "charitable" in English law. It might be accepted that not all public benefit activities facilitated at *Tier 1* or promoted at *Tier 2* should also be eligible for subsidy through the tax system, but one might wish for a more straightforward criterion for applying tax reliefs than the English definition of charity.

Failures of Coherence

The foregoing account of the Scottish public benefit system has described the main strengths and weaknesses of each of its three "tiers" or layers. The account can be concluded by a brief assessment of the system as a whole, identifying in particular its "failure of coherence".

First of all, it is a strength of the system as a whole that it operates at different "tiers", or levels. There is much to be said for distinguishing treatment of the "basic", or "first level", PBO - which derives its funds only from the gift of an original founder-benefactor or from the contributions of its members - from (1) (at the next level) the PBO which invites funding from the public at large and (2) (at a higher level still) the PBO which receives automatic subsidy from the state in the form of tax relief. It makes sense in principle that a public benefit system should respond appropriately to these three different degrees of public interest in a PBO. Likewise, there is a strong case for saying that the "basic" level - and perhaps also the "fund-raising" level - should be inclusive, and that the types of public benefit admitted to the system should not be artificially restricted (and particularly not by reference to criteria established in 1601). There is, however, an equally strong case for saying that the PBOs which are to be given active support by the state in the form of tax relief should be subject to some special form of selection. The state might be willing to facilitate PBOs of every possible kind at the basic level but be unwilling (or unable) to promote them all financially.[53]

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52 This is the verdict of the English judges themselves: e.g. *Income Tax Special Commissioners of Income Tax v Pemsel, supra,* per Lord McNaghten at 583 et seq,. *Re Macduff, supra,* per Lindley LJ at 464.

53 See *Dingle v Turner, supra*, per Lord Cross of Chelsea at 624, endorsing a recommendation of the "Radcliffe Commission". *Pace* the Deakin Report, p.90.

The fundamental weakness of the Scottish system as a whole is that its three tiers do not fit cohesively together. Its legislative elements have not been integrated coherently with its common law foundation, with the result - most significantly - that PBOs operating quite legitimately at *Tiers 1* and *2* may be inadequately regulated because not falling within the scope of the supervisory mechanisms of *Tier 3*.

Agenda for Coherence

Any "agenda for coherence" must, clearly, tackle this fundamental weakness of structure as well as the individual weaknesses of the separate tiers. The proposals which follow are intended to do so by sketching a general outline of how a reformed Scottish public benefit system might look. In the light of the analysis of the existing system set out above, the policy objectives of a reformed system might be restated as follows:

1. The system should *facilitate* the formation by private individuals of PBOs which benefit the public in the widest possible variety of ways. Facilitation should include the provision of new legal forms, designed specifically for PBOs and offering the advantages of incorporation and limited liability.

2. The system should *promote* the work of PBOs by providing (1) a regulated framework for direct financial support by members of the public and (2) a coherent scheme of state subsidies including subsidy by tax relief.

3. The system should *regulate* the operation of PBOs to ensure that assets nominally dedicated to public benefit are in fact used for public benefit.

These policy objectives might find expression in a reformed Scottish system which retained, but adapted, the existing three-tiered structure, along the following lines:

New Tier 1: Public Benefit

Definition: *New Tier 1* would be defined by reference to the existing Scots common law concept of public benefit.[54] The guiding principle would be to bring within the system PBOs performing publicly beneficial activities of all possible kinds. The legislature would have the opportunity to review the treatment of certain types of organisations (such as campaigning organisations) at present on the margins of the

54 As outlined at *Tier 1* above.

definition.[55]

Facilitation: *New Tier 1* would offer "dedicated" legal forms for PBOs, distinct from the commercially orientated forms of the Companies Act but allowing PBOs to incorporate with limited liability.[56] *New Tier 1* would also facilitate the reorganisation of PBOs (regardless of legal form) by enabling assets held for public benefit on redundant terms to be brought back into fruitful use. All other facilitatory mechanisms - such as review of dormant bank accounts - would be made available at this level of the system.

Regulation: PBOs admitted to the system at *New Tier 1* would be constituted, by definition, for the benefit of the public and should be regulated accordingly - even if funded exclusively by the generosity of an original founder-benefactor or by the contributions of its members. The main regulatory mechanisms of the system - investigation, intervention, public accountability in all its forms (strengthened and reformed as necessary) - would therefore apply at *New Tier 1*. In particular, there would be a definitive register of PBOs (subject to a *de minimis* exemption for "small" PBOs). The regulatory controls would cover all PBOs without distinction between legal forms.[57]

New Tier 2: Fund-raising

Definition: *New Tier 2* would also be defined by reference to the existing Scots common law concept of public benefit. The guiding principle for this tier would be that additional arrangements are necessary for PBOs which solicit funding from the public at large. The definitional match with *New Tier 1* is deliberate, but exceptional provision would be made to allow fund-raising for the benefit of individuals or groups of individuals not amounting to a section of the public.

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55 See *McGovern v A-G,* supra.

56 The work of Jean Warburton in this area is well known, (e.g; Warburton J, "Charity Corporations; The Framework for the Future?"[1990] Conv.95) as is the continuing research on "charity forms" being undertaking by the Charity Law Unit at the University of Liverpool in partnership with the Charity Law Association and NCVO. See also the Deakin Report, p.84 and the Kemp Report, p.70 (approving the Deakin recommendations and adopting representations of SCVO). To a Scottish eye, an attractive model is the French system of *fondations* and *associations d'utilité publique*, which perform the same socio-economic functions as the Scottish public trust and unincorporated association with public objects: see generally Lepeltier and Streiff, *Associations, Foundations, Congrégations* (1994).

57 Educational endowments could be brought within the general *New Tier 1* regime if found to be inadequately regulated as part of the education system.

Promotion: *New Tier 2* would promote the operation of PBOs by allowing them to raise funds from the general public.

Regulation: Only PBOs fully regulated at *New Tier 1* would be permitted to raise funds from the public.[58] Additional regulatory mechanisms would apply at *New Tier 2* to cover fund-raising in all its modern forms. PBOs, rather than individual fund-raisers, would be primarily responsible for the conduct of fund-raising and for the proper application of funds raised. Fund-raising for the benefit of individuals or groups not amounting to a section of the public would be permitted, but only if conducted by a PBO and on condition that funds surplus to the needs of the "private" beneficiaries would be applied to the objects of the PBO.

New Tier 3: "Public Service" Tax Relief

Definition: *New Tier 3* would, ideally, be defined by reference to a comprehensive socio-economic policy for support of the voluntary sector as a whole - in which state subsidy for PBOs by tax relief would, no doubt, play an important part. The guiding principle would be that the allocation of state subsidy by tax relief is a question of policy, to be reviewed by government from time to time in exactly the same way as other socio-economic policies. It would not be expected that all PBOs admitted to the system at *New Tier 1* would be entitled to tax relief, but only those offering some specially beneficial range of services to the public. It would be for the United Kingdom Parliament to decide exactly what the scope of this "public service" tax relief should be. Until radical reform of charity tax relief is undertaken at United Kingdom level, however, it would be accepted that the English definition of "charitable" must remain the principal criterion of tax relief for Scottish PBOs.[59]

Promotion: *New Tier 3* would promote the operation of PBOs by providing financial support from the state in the form of tax relief.

Regulation: In principle, all PBOs would be adequately regulated at *New Tier 1*, so that any additional regulation applied at *Tier 3* would be applied as part of the tax system, not as part of the public benefit system. There would be all the usual compliance and anti-avoidance mechanisms associated with the tax system, but the regulation of PBOs as such would not be a function of eligibility for tax relief.

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58 "Small" PBOs exempted from the full regulatory force of *Tier 1* would be permitted to raise funds only under the sponsorship of a larger PBO.

59 Subject to the different systems of reliefs for VAT and the power of the new Scottish Parliament to control local government taxation.

It is submitted that a system along the above lines would remedy the failures of coherence identifiable in the present system. All PBOs entering the system would be fully facilitated and regulated at *New Tier 1,* regardless of legal form. Any *New Tier 1* PBOs which sought to raise funds from the public would be subject to additional regulation at *New Tier 2* covering all modern techniques of fund-raising, and no individuals, or organisations other than fully regulated PBOs, would be permitted to raise funds from the public. A defined range of fully regulated PBOs would be entitled to "public service"tax relief, on a basis to be decided on socio-economic policy grounds by the United Kingdom Parliament - which failing, the selection would continue to be made by reference to the existing criterion of the English definition of "charitable".

Competence of Scottish Parliament to enact Reforms

These proposals are offered as an "agenda for coherence" in any reform of Scottish charity law - or rather of Scottish public benefit law - which might be undertaken by the new Edinburgh Parliament. The reforms suggested at *New Tiers 1* and *2* would, it is submitted, lie within the new Parliament's devolved powers, as modifying an area of Scots private law, provided that (as they would) they affected "charitable" and non-charitable PBOs consistently.[60] Any criminal offences to be created in support of the reformed system in relation to unauthorised public fund-raising would also be within the devolved powers.[61] Limited reform could also be achieved in Edinburgh at the level of tax relief by adjustment of the basis on which PBOs are relieved from local authority taxation.[62]

It is at *New Tier 3,* however, that the yoke of Westminster would continue to rub irritatingly for the reformers. Viewed from Scotland, the English definition of charity looks far from satisfactory as a criterion for "public service" tax relief - and far from coherent with the rest of our system. Yet, to put it bluntly, until a United Kingdom government takes a real grasp of the nettle of charity tax reform,[63] PBOs in Scotland, whatever the new Scottish Parliament might think, are going to have to

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60 Scotland Act, s.29(1)and Sched 5, Part II, section CI: but the Secretary of State would have power to intervene under s.35 of the Act.

61 As not reserved under Schedule 5 of the Scotland Act.

62 Scotland Act, Sched. 5, Pt II, section AI.

63 The Treasury's current review of the taxation of charities appears to be concerned chiefly with the mechanics of relief, not with the fundamental question of eligibility.

put up with it.[64]

64 The writer is most grateful to Professor Ian Willock and to colleagues at the Charity Law Research Unit, all of the Department of Law, University of Dundee, for generous assistance with this article. He is especially grateful to Stephen J A Swann for an analysis of the impact of the Scotland Act 1998 on Scottish charity law. It is emphasised, however, that the article has been prepared independently of the research on Scottish charity law being carried out by the Unit for the Scottish Office and that the views expressed in the article are not those of the Unit but the writer's own.