



National Audit Office

Report

by the Comptroller
and Auditor General

Charity Commission

The Cup Trust

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 860 staff. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of almost £1.2 billion in 2012.



National Audit Office

Charity Commission

The Cup Trust

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 2 December 2013

This report has been prepared under Section 6 of the
National Audit Act 1983 for presentation to the House of
Commons in accordance with Section 9 of the Act

Amyas Morse
Comptroller and Auditor General
National Audit Office

21 November 2013

This report sets out the key stages of the Charity Commission's investigation of The Cup Trust, including its consideration of whether the Trust met the legal criteria to register as a charity, and the actions it took to deal with the concerns it identified.

© National Audit Office 2013

The text of this document may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not in a misleading context.

The material must be acknowledged as National Audit Office copyright and the document title specified. Where third party material has been identified, permission from the respective copyright holder must be sought.

Links to external websites were valid at the time of publication of this report. The National Audit Office is not responsible for the future validity of the links.

Printed in the UK for The Stationery Office
Limited on behalf of the Controller of Her
Majesty's Stationery Office

2604094 11/13 PRCS

Contents

Key facts 4

Summary 5

Part One

Background to The Cup Trust 9

Part Two

Investigation 15

Part Three

Events since the investigation ended 22

Appendix One

Timeline of events in the
Commission's investigation 26

The National Audit Office study team consisted of:
Fiona Nicolle, John Hoadly and Emma Taylor, under the direction of Victoria Keilthy.

This report can be found on the National Audit Office website at www.nao.org.uk/2013-cup-trust

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

£46m

value of Gift Aid claims submitted by The Cup Trust to HMRC. These have not been paid

£152,292

value of donations The Cup Trust has made to charitable causes up to 31 March 2013

£176m

value of payments to The Cup Trust in relation to the tax avoidance scheme

Two years

the time the Charity Commission's investigation of The Cup Trust took before the investigation was closed with regulatory advice to the Trustee

Summary

1 The Charity Commission (the Commission) regulates charities in England and Wales. Its statutory objectives include promoting public trust and confidence in charities and regulating their compliance with charity law. The Commission's core regulatory activities include registering charities and investigating regulatory concerns, including using its powers to protect and recover charitable assets where there is mismanagement or misconduct.

2 The Cup Trust (the Trust) was registered as a charity by the Commission in April 2009. The Trust has a sole corporate trustee, a company called Mountstar (the corporate Trustee), registered in the British Virgin Islands.

3 In March 2013, the Committee of Public Accounts held a hearing, attended by representatives of the Commission and HM Revenue & Customs (HMRC), to investigate concerns that the Trust was set up as a tax avoidance scheme. The Committee's report in June 2013 concluded that the Trust does not meet public expectations of a charity.¹ It also said that it was unacceptable for the Commission not to have been able to stop this instance of abuse of charitable status.

4 On 4 December 2013, the Comptroller and Auditor General published a report *The regulatory effectiveness of the Charity Commission*.² The report was prepared under Section 6 of the National Audit Act 1983 for the purpose of examining the economy, efficiency and effectiveness with which the Commission has used its resources in discharging its functions. This report has been prepared under the same legislation and for the same purpose, and examines the Commission's investigation of The Cup Trust case. We set out the key stages of the Commission's investigation of the Trust, including its consideration of whether the Trust met the legal criteria to register as a charity, and the actions it took to deal with the concerns it identified.

5 We reviewed the Commission's case records and published information, and interviewed the Commission's chief legal adviser and head of legal services (the director of legal services and compliance up until December 2011), the head of Investigations & Enforcement, and the manager in charge of the investigation team for the case. We could not interview the Commission's lead investigator or advising lawyer for the first investigation into the Trust because they left the Commission in 2012. We also took legal advice. Appendix One sets out a timeline of the case.

¹ HC Committee of Public Accounts, *Charity Commission: The Cup Trust and tax avoidance*, Seventh report of Session 2013-14, HC 138, June 2013.

² Comptroller and Auditor General, *The regulatory effectiveness of the Charity Commission*, Session 2013-14, HC 813, National Audit Office, December 2013.

Key findings

6 The Cup Trust submitted claims for £46 million Gift Aid on £176 million of payments from participants to the tax avoidance scheme, but it gave just £152,292 to charitable causes between April 2009 and March 2013. HMRC made clear it did not think Gift Aid was payable in schemes of this type, and it has not paid the Gift Aid claims (paragraphs 1.3 to 1.7, 2.7 and 2.28).

7 When registering a charity the Charity Commission, as a general rule, can only take into account an organisation's expressed purposes, not its activities or the motives of its founders. If the trustees of a charity fail to ensure that it carries out its charitable purposes, or if it carries them out in breach of the relevant legal duties and powers, then the organisation is still charitable, but its trustees may be in breach of trust (paragraphs 1.9 to 1.11).

8 The Commission did not properly consider whether the Trust met a key legal requirement before registering it. Before registration, the Commission did not adequately examine whether the Trust fell within the jurisdiction of the High Court. The Commission did not obtain external legal advice until 2011 when it was investigating the Trust. It also did not identify as a risk factor the potential conflict of interest arising from having a sole corporate trustee (paragraphs 1.13 to 1.16, 2.10 and 2.11).

9 The Commission took action when it received information from external sources. The Commission opened an investigation in March 2010 after receiving information from HMRC. After closing the investigation in March 2012, pending HMRC determination of the Gift Aid claim, the Commission did not formally monitor the Trust until February 2013. The Commission opened a statutory inquiry in April 2013, based on its own concerns about the charity and new information from HMRC. The Commission's decision to open the inquiry and appoint an interim manager was upheld by the First-tier Tribunal (Charity) in its judgment of October 2013 (paragraphs 2.6, 2.26 and 3.7 to 3.11).

10 In our view, there were issues that might have justified the opening of a statutory inquiry in 2011, to which the Commission did not give sufficient weight during its investigation. Following its investigation the Commission concluded that it could not deregister the Trust on grounds of lack of jurisdiction or on the grounds that it was a sham charity. In June 2011, it wrote to the Trustee setting out its regulatory concerns about the Trust's jurisdiction, status and activities. After receiving assurances from the Trustee, the Commission decided not to open an inquiry and closed its investigation in March 2012, choosing instead to wait for HMRC to determine the Gift Aid claim. In deciding not to open an inquiry, we believe the Commission did not give sufficient consideration to issues such as the public detriment arising from the diversion of taxpayer funds and the failure of the Trust to take its own independent legal advice on whether running the scheme was an appropriate activity for it to undertake (paragraphs 2.21, 2.23, 2.24, 2.27, 2.29 and 2.34).

11 The First-tier Tribunal (Charity) judgment of October 2013 concluded that the Commission's strategy to close the investigation and await an HMRC determination was mistaken. The Commission has now accepted this (paragraph 3.11).

12 The Commission was slow to appreciate the potential impact of the case on public confidence in charities, which it has a statutory duty to increase. The Commission should have considered issues of public confidence more fully when deciding in early 2011 not to open a statutory inquiry. When it closed its investigation in March 2012, the Commission decided not to publish its findings. This was on the grounds that the case was not of significant public interest, and that public confidence in charities would not be enhanced by wider discussion of the issues. The Commission subsequently decided, on 1 February 2013, that it was in the public interest to publish a report on the case (paragraphs 2.30, 2.31 and 3.5).

13 The Commission did not take sufficient account of the scale and nature of the tax avoidance scheme in its case strategy. Although the Commission raised all the key issues with the Trust and sought legal advice, in reaching its decision to close the case, the Commission does not seem to have taken sufficient account of the magnitude of the avoidance scheme, or that materially all of the Trust's funding would have come from Gift Aid. This was despite HMRC making clear that it did not think that Gift Aid was payable on this type of scheme (paragraphs 2.7, 2.10, 2.15 and 2.28).

14 The Commission was narrowly focused on the legal position and paid insufficient attention to the wider issues of public detriment which it would have been appropriate to pursue further. Although the Commission asked the Trust about the wider issue of public detriment from diversion of funds from the Exchequer, it placed too much reliance on the view that tax avoidance schemes were a legitimate activity for charities and that it was for HMRC to pursue tax issues. Furthermore, the Commission did not adequately pursue other lines of investigation, such as potential conflicts of interest of the Trustee's directors or the fact that the Trustee had not taken independent advice on whether it was appropriate for The Cup Trust to enter into the scheme (paragraphs 2.29, 2.32 to 2.34 and 3.11).

15 In assessing whether tax avoidance was acceptable for charities, the Commission used advice from 2001 relating to a materially different type of scheme. The Commission is now reviewing its policy on the use of tax avoidance schemes, such as the one the Trust was involved with, and whether they are a proper activity for charities to undertake (paragraphs 2.17 and 2.18).

16 The Commission was slow in handling the case. The Commission took two years to investigate the Trust, including ten months to gather information. It opened a statutory inquiry into the Trust more than three years after its initial investigation began (paragraphs 2.12, 3.7 and Appendix One).

17 From its work to date, the Commission has concluded that the register of charities does not include any other charities like The Cup Trust. The Commission reviewed its register to identify charities with characteristics similar to The Cup Trust, such as low charitable expenditure as a proportion of income. It identified potential regulatory issues in 13 charities and is looking into these issues, but has concluded that it is unlikely that there are charities similar to The Cup Trust on the register. HMRC has confirmed to the Commission that The Cup Trust is the only charity in England and Wales included within the eight avoidance schemes involving charities that have been disclosed to HMRC (paragraph 3.12 and Figure 2).

Conclusion

18 The Commission's approach to The Cup Trust case was too passive. The Commission did not make enough checks when it registered the Trust in 2009 to ensure the organisation met the legal requirements to register as a charity. The Commission was reluctant to take strong action during initial investigation and did not open a statutory inquiry in 2011.

19 The Commission took too narrow a view of its remit, seeing the scheme as something for HMRC to deal with rather than seeing the bigger picture. It did not fully appreciate the scale and nature of the Gift Aid scheme nor the potentially detrimental impact of the case on public confidence in charities. The Commission is now reviewing its policy on the use of tax avoidance schemes by charities. It has opened an inquiry and is exercising its legal powers, which has been supported by the First-tier Tribunal (Charity).

Part One

Background to The Cup Trust

1.1 This part sets out how The Cup Trust (the Trust) is structured, how the tax avoidance scheme operated and the Charity Commission's (the Commission's) registration of the Trust as a charity.

1.2 The Trust was established on 10 March 2009. The Commission registered the Trust as a charity a month later on 7 April 2009. The Trust is governed by a sole corporate trustee, Mountstar (PTC) Limited (the Trustee). The corporate Trustee company had, until recently, three directors³ and is registered in the British Virgin Islands.

1.3 According to its governing document, the Trust was established as a general grant-making charity with the intention of giving grants to small or start-up charities that aim to improve the lives of children and young adults. Between 2009-10 and 2010-11, the Trust had income of £177 million.⁴ It gave £152,292 to charitable causes between April 2009 and March 2013.⁵

1.4 Between January and November 2010, the Trust participated in a complex tax avoidance scheme (the scheme) designed to enable the Trust and the participants in the scheme (the participants) to claim Gift Aid tax relief on payments to the Trust.

³ It now has two directors.

⁴ The Trust income of £177 million comprises £176,421,762 of payments to The Cup Trust in relation to the scheme and £110,000 of other voluntary income.

⁵ According to the judgment of the First-tier Tribunal (Charity), in the period April 2009 and March 2013, the Trust received direct donations of £115,000, and £155,000 in donations from participants in the scheme and from the sale of the gilts. It funded its donations to charitable causes from these sources of income.

Source: First-tier Tribunal (Charity), *Appeal numbers CRR/2013/0001 and CRR/2013/0003, Mountstar (PTC) Limited and the Charity Commission for England and Wales, Decision and Reasons*, 17 October 2013. Available at: www.charity.tribunals.gov.uk/documents/decisions/mountstar-decision-17Oct2013.pdf, paragraphs 14 to 16.

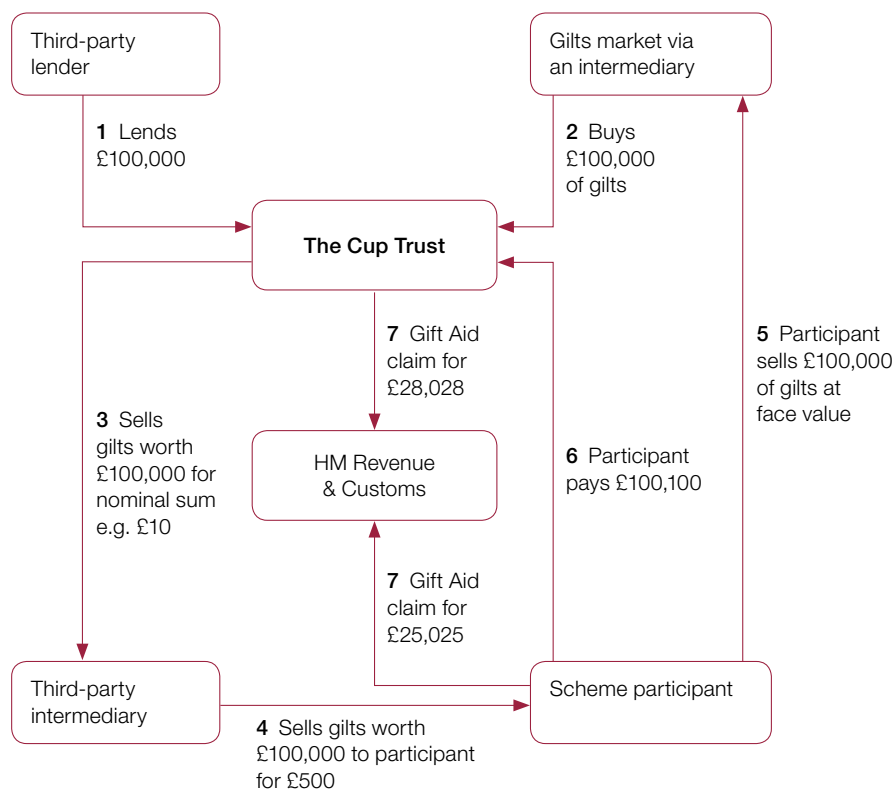
How the scheme operated

1.5 The scheme was based on a circular series of payments that sought to generate repayments of tax under Gift Aid (**Figure 1**). The scheme worked in the following way:

- The Trust borrowed money from a third-party lender and used this to buy government gilts at market value.
- The Trust then sold the gilts for a minimal sum to a third-party intermediary who was acting for the participants. (These participants were higher-rate taxpayers who would benefit personally from Gift Aid tax relief.) It was a condition of the sale that the third-party intermediary secured a donation to the Trust from the participants within 48 hours, which was equivalent to the market value of the gilts. If this donation was not made the gilts would all be returned to the Trust. Thus, the charity technically avoided selling the gilts at a loss, which would potentially have been a breach of the Trustee's duties.
- The third-party intermediary sold the gilts to the participants for a minimal sum on condition they donated the full market value of the gilts to the Trust within 24 hours.
- The participants sold the gilts for market value and donated the proceeds to the Trust.
- The Trust repaid its loan with the money received from participants, and later submitted a claim to HM Revenue & Customs (HMRC) for Gift Aid on the payments received.

1.6 The scheme was promoted by a tax advisory partnership called HNW Tax Advice Partners run by two partners, Matthew Jenner and a trust of which Mr Jenner was the beneficiary. Mr Jenner was also a director of the corporate Trustee, Mountstar (PTC) Limited, although he resigned from this position at various points when the scheme was being run.

Figure 1
The Cup Trust tax avoidance scheme



1 and 2 The Cup Trust borrows £100,000 and buys government gilts via an intermediary.

3 The Cup Trust sells gilts to another third-party intermediary for a nominal sum, e.g. £10, on condition that the intermediary secures a payment of £100,000 to the Trust within 48 hours. If no payment is made, the gilts will be returned to the Trust, so there is no risk that the charity loses money on the sale.

4 The intermediary sells the gilts to a participant, e.g. for £500 making a profit of £490. The participant agrees to pay £100,000 to the Trust within 24 hours.

5 and 6 The participant sells the gilts at face value for £100,000 and pays the proceeds to the Trust, plus £100 to show it is a gift.

7 The participant claims Gift Aid tax relief of £25,025 (25 per cent of £100,100) but has only paid out £500 to the intermediary and £100 to the Trust.

The Trust claims Gift Aid of £28,028 (28 per cent of £100,100) but is only £110 better off (£100 from participant and £10 from intermediary).

Notes

- 1 The values in this figure are used for illustrative purposes only and are not intended to represent actual transactions made under the scheme.
- 2 In practice, on every occasion the scheme was used, all the transactions occurred on the same day and involved several participants.
- 3 The diagram does not show fees payable by participants or The Cup Trust to the scheme promoter and third-party intermediary in the event that the Gift Aid claims succeed.
- 4 A gilt is a UK government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange.

Source: National Audit Office review of Commission's investigation papers

1.7 During 2010, the Trust operated the scheme ten times: five times between 30 January and 20 March 2010, and five times between 21 June 2010 and 28 November 2010.⁶ It received a total of £17,000 from the sale of the gilts to the third-party intermediary, plus £176 million from the participants. The Trust subsequently submitted Gift Aid claims to HMRC, totalling £46 million, in respect of the £176 million that it claimed were charitable donations. It is estimated that participants could have benefited from tax relief totalling up to £55 million.⁷

1.8 According to the First-tier Tribunal (Charity) hearing in September 2013, the scheme promoter, HNW Tax Advice Partners, has received up front fees of £704,000. The scheme promoter may receive additional fees of £3.5 million from participants, and the third-party intermediary may receive £6.3 million of fees from the Trust if the Gift Aid claims are accepted by HMRC.⁸

Registration

Criteria for registration

1.9 To register as a charity, an organisation must:

- be set up for exclusively charitable purposes;
- have purposes that are for public benefit; and
- fall within the jurisdiction of the High Court of England and Wales.

If the Commission is satisfied these criteria are met, and the charity has an income of at least £5,000, then, by law, it must add the organisation to the register of charities.

1.10 An organisation's charitable purposes are defined in its governing documents. On registration, it is these purposes – not its activities or the motives of its founders – that the Commission has to consider in determining whether or not it is a charity. The Commission cannot refuse to register a charity because its structure is complex or because the Commission suspects it will carry out non-charitable activities, although it can question how the charity proposes to carry out its purposes. If there is evidence later on which shows the organisation has been set up to carry out non-charitable activity and is therefore a sham, the Commission may remove the charity from the register.

⁶ See source in footnote 5, paragraphs 30, 34 and 35.

⁷ See source in footnote 5, paragraph 26.

⁸ See source in footnote 5, paragraphs 37 and 40.

1.11 The trustees of a charity may fail to ensure that it carries out its charitable purposes, or may carry them out in breach of the relevant legal duties and powers. In this case, the organisation is still charitable but its trustees may be in breach of trust. If they are in breach of trust, they will be personally accountable for any loss to the charity. In the first instance, the Commission expects any independent trustees to investigate and, if appropriate, consider legal proceedings against the trustees at fault. The Commission has powers to investigate charities and to open statutory inquiries. It can install an interim manager or appoint new trustees to take charge of the charity if misconduct or mismanagement is found or if there is risk to the charity's assets.

1.12 The Commission operates a fast-track registration process for those registration applications which use standard charity governing documents and where the Commission judges the application to be low risk.

Registration of The Cup Trust

1.13 On 30 March 2009, The Cup Trust applied to register as a charity. The Trust's registration application showed that it had a sole corporate Trustee registered in the British Virgin Islands, a known tax haven. It named Matthew Jenner as the contact point for the application, and gave Mr Jenner's corporate email address at NT Advisors. The Commission did not recognise any risks arising from these facts. The Commission judged the application to be low risk and fast-tracked the application. It registered the Trust as a charity on 7 April 2009.

1.14 The Commission acknowledged in March 2013, at the Committee of Public Accounts' hearing on The Cup Trust, that a charity with a single company as trustee, registered in a tax haven, should have been a 'red flag'. This should have led to the Commission asking more questions at registration.

1.15 Before registering the Trust, the Commission should have considered more thoroughly whether the Trust was within the jurisdiction of the High Court of England and Wales, a statutory requirement of registration (paragraph 1.9). The Commission considered the legal position in 2011 about whether it could deregister the Trust on jurisdiction grounds, which suggests that it had not considered the issue of jurisdiction in sufficient detail at registration.

1.16 The Commission should also have asked more questions about potential conflicts of interest, which would be difficult to manage with a sole trustee. It should also have considered whether any risks arose from links between the corporate Trustee, its directors and other organisations of which those individuals were the directors, partners or associates. Although it may not have found issues that would have prevented it from registering the Trust, the Commission could have asked more questions prior to registration. A more probing approach might have highlighted issues that would have prompted close monitoring of the Trust post-registration.

Changes to the registration process

1.17 The Commission has changed its registration process since registering the Trust in April 2009. It revised its risk framework in March 2011 and gave staff guidance on how the risk framework applies to registration. The guidance sets out which factors to consider for registration applications. It requires staff to assign a risk rating, which determines the Commission's approach to assessing the application. The guidance also states that applications from organisations with the following features – which were present in The Cup Trust – should be assessed as high risk:

- Not independent of non-charitable entities or of commercial, government or political interests.
- Complex structure.

1.18 In February 2013, the Commission re-introduced a process to monitor concerns identified at registration. In the following six months, 27 cases out of about 3,000 applications were referred by the registration division to the Commission's operations division for monitoring.

1.19 HMRC and the Commission are in the planning stages of a joint project to create a single portal for charities to register with both HMRC and the Commission. The proposed changes will not involve either organisation changing the criteria for their registration process, but should lead to them sharing more information when organisations apply to register. This should reduce the risk of an organisation being registered as a charity when it should not be.

Part Two

Investigation

2.1 This part covers the Charity Commission's (the Commission's) initial investigation into The Cup Trust (the Trust), which took place between March 2010 and March 2012.

Actions immediately after registration

2.2 Between registration in April 2009 and March 2010, the Commission had no contact with the Trust. When it registered the Trust, the Commission did not identify it as a charity that required monitoring. The Commission told us there was little it could have done in this period since the Trust's annual return and accounts were not due until 31 January 2011. There is also no legal requirement for charities to undertake any activity within a set time frame, for example within its first year of operation.

Opening the investigation

Powers to investigate a charity

2.3 When the Commission has regulatory concerns about a charity, it can inspect the charity's books and records, and raise queries to which trustees must respond.

2.4 In the most serious cases, the Commission may use its powers under section 46 of the Charities Act 2011⁹ to open a statutory inquiry. A statutory inquiry is a detailed investigation into a charity's administration and management and the trustees' compliance with their legal duties. Before opening a statutory inquiry, the Commission usually carries out a preliminary assessment to see whether an inquiry is required and justified.

⁹ At the time of the Commission's initial investigation, the power was in section 8 of the Charities Act 1993.

2.5 The Commission opens an inquiry where there is a serious regulatory issue, and in circumstances where there is evidence or suspicion of misconduct or mismanagement or where there is a high risk to the charity or to public confidence in charities more generally. The Commission has several powers it can use during a statutory inquiry to protect charitable assets. These include suspending or removing charity trustees, appointing new trustees or an interim manager, and restricting the charity's transactions.

Deciding to investigate the Trust

2.6 On 21 March 2010, almost a year after the Trust was registered, the Commission opened an investigation (known as a regulatory compliance case)¹⁰ into the Trust. This was shortly after it received information from HM Revenue & Customs (HMRC) that raised concerns about the Trust's governance, activities, and how funds were being raised and applied through a tax avoidance scheme.

2.7 On 29 March 2010, HMRC put a notice on its website describing a scheme similar to that used by the Trust.¹¹ It stated that "HMRC do not accept that the charity is entitled to a repayment of tax or that Gift Aid tax relief is due to the individual. In HMRC's view a gift has not been made to the charity as it is no better off than before entering the arrangements. Therefore, according to HMRC, Gift Aid is not due."¹²

Conclusion on Commission opening an investigation

2.8 The information the Commission received gave it cause for concern. However, the Commission concluded it was insufficient, on its own, to demonstrate misconduct or mismanagement in the Trust's administration, which is the test that needs to be met for the Commission to use its powers in a statutory inquiry. We conclude that it was reasonable for the Commission to open an investigation to gather more information before deciding whether a statutory inquiry was justified.

¹⁰ Before its reorganisation in December 2011, the Commission used 'regulatory compliance cases' for investigating serious concerns where a statutory inquiry was not justified.

¹¹ HM Revenue & Customs, *Spotlight 9: Gift Aid with no real gift*, 29 March 2010, available at: www.hmrc.gov.uk/avoidance/spotlights9.htm. HM Revenue & Customs issues spotlights to warn people about specific tax avoidance schemes that it is likely to challenge.

¹² Although The Cup Trust was £155,000 better off under the scheme, HMRC's statement would apply to the remaining £176 million of payments on which the Trust was claiming Gift Aid.

Conduct and focus of the investigation

2.9 On 22 April 2010, a month after receiving information from HMRC, the Commission wrote to the Trust setting out its regulatory concerns and requesting detailed information about the Trust's administration and operations.

2.10 The Commission's investigation focused on the following regulatory issues:

- Whether the Trust was established as a charity, in particular, whether it was within the jurisdiction of the High Court of England and Wales; and whether its purposes were exclusively charitable.
- Whether the directors of Mountstar (PTC) Limited (the corporate Trustee) discharged their legal duties properly in the charity's administration, bearing in mind how the Trust raised and applied funds; and the Trustee's decision-making. The Commission also examined how the risks to the charity were identified and managed, including any conflicts of interest.¹³

2.11 The investigation's first issue, of whether or not the Trust met the legal definition of a charity (specifically whether it fell within the jurisdiction of the High Court), should have been resolved before registration.

2.12 The Commission spent ten months, from 22 April 2010 to mid-February 2011, gathering and analysing evidence on the Trust's activities. It worked to understand the tax avoidance scheme and the parties connected with the Trust.

2.13 The Commission sought information through a number of routes. These included: written requests to the corporate Trustee's directors; meetings with the corporate Trustee's directors in July and December 2010; reviewing the Trust's books and records in December 2010; and liaising with HMRC. During this time, the corporate Trustee's directors generally provided the requested information within the timescales set by the Commission or soon after.

2.14 On 14 December 2010, the investigations team and the Commission's in-house legal advisers met to decide what action to take. It agreed to seek external legal advice on the issues identified.

¹³ The conflicts of interest issue arose from: a) Matthew Jenner, one of the directors of the Trust's corporate Trustee, also being a partner in HNW Tax Advice Partners, the scheme promoter, which stood to make fees from the scheme; and, b) all three directors of the corporate Trustee also being directors, at various times, in a company that is part of the scheme. See source in footnote 5, paragraphs 13, 36 to 37 and 174.

Request for external legal advice

2.15 On 14 February 2011, the Commission issued instructions to counsel. The Commission's instructions to counsel were comprehensive and contained all the relevant information to allow counsel to conclude on the issues on which his advice was sought.

2.16 The Commission met counsel on 15 March 2011, and he subsequently provided a written opinion on 28 March 2011. The Commission did not make a note of the 15 March meeting as it agreed with counsel that his subsequent written advice would serve as a record of the advice given and as counsel wanted to reflect further.

2.17 The Commission's policy on tax avoidance is based on principles established in a legal opinion from 2001 relating to a charity being involved in a tax-saving scheme. The nature of this scheme was very different to the scheme used by the Trust. The tax losses in the 2001 scheme could potentially have been used even if this scheme had failed, so the tax saved by the participants in this scheme did not necessarily involve tax being lost to the public purse. By contrast, in the case of the Trust, almost all of the Trust's funds would have come from the public purse as Gift Aid. The Commission acknowledges that the cases were different in nature but considers that the principles in the 2001 case were relevant to The Cup Trust case.

2.18 It was only recently, in June 2013, that the Commission began a review of its policy on the use of tax avoidance schemes, such as the one the Trust was involved with, and whether such schemes are a proper activity for trustees to carry out under charity law.

Commission's action in response to legal advice

2.19 After receiving counsel's advice, the Commission held a case strategy meeting on 6 April 2011, where it considered several options. At the case strategy meeting, the Commission narrowed its decision to two possible options:

- Deregister the Trust on non-charitable status and jurisdiction grounds. The Commission's argument in favour of this option was to protect the reputation of charities and public confidence.
- Disengage, reiterating the duties and responsibilities of the charity Trustee and leave HMRC to deal with the Gift Aid claims. The Commission noted that this would probably necessitate follow-up action to ensure that, if the Gift Aid claim succeeded, these funds were used for charitable purposes. The Commission's arguments in favour of this option included the need for it to use its resources in a strategic and risk-based way.

2.20 The Commission did not reach a final decision at this meeting, and it agreed that the director of legal services and compliance would discuss the two options with a board member.

Decision not to open an inquiry

2.21 The Commission did not believe it had sufficient evidence at that stage to open a statutory inquiry and exercise powers on the basis of concerns about the administration of the Trust.

2.22 In April 2011, the Commission's director of legal services and compliance met a member of the Commission's board to discuss the Commission's two preferred options (deregistration, or letting HMRC deal with the Gift Aid claim). There is no formal record of this meeting but the points arising were set out in an internal email and a written report was made to the board at its meeting on 25 May 2011. The report to the board stated that: "Counsel's advice was received. Following a case strategy meeting, two possible outcomes were identified. The first outcome is to remove the Charity from the Register on grounds of jurisdiction and charitable status and ensure the remaining funds are expended. Secondly, the trustees may be in breach of their fiduciary duties by entering into these arrangements. We are drafting a letter putting our current findings to the Charity for their response, doubting whether the trust is properly registerable with the Commission as a charity and advising them (on the basis it is a charity) that we regard them as being in breach of their fiduciary duties to administer the Trust for the public benefit."

2.23 Two months later, on 6 June 2011, the Commission wrote to the Trust setting out its regulatory concerns in full and asking the Trust to respond. On 3 August 2011, the Trust's lawyers responded in detail. They refuted the Commission's suggestion that the Trust was not established for exclusively charitable purposes and had a collateral non-charitable purpose (that is, tax avoidance). They denied that there had been misconduct or mismanagement by the directors of the Trustee.

2.24 On 8 August 2011, the Commission decided it did not have sufficient evidence to deregister the Trust on grounds of jurisdiction or to demonstrate that it had a collateral non-charitable purpose. After reviewing the Trust's lawyers' response, the Commission was content that the response did not raise any new concerns or evidence and it decided to close the case by giving the Trustee regulatory advice and guidance. This approach was in line with the option to let HMRC deal with the Gift Aid claim agreed in April 2011 (paragraph 2.19).

Concluding the investigation

2.25 Although it had decided in August 2011 in principle to close the case, the Commission continued to gather information from the Trust during September and October 2011 to see if any further issues emerged. The Commission also continued to liaise with HMRC between August 2011 and January 2012 to press for information that could be used as evidence and verify what it had been told by the Trustee, but it did not receive any further information that it could use as evidence to progress its investigation.

2.26 On 7 March 2012, seven months after it had decided to close the investigation, the Commission wrote and told the Trust of its decision to close the investigation. The Commission gave the Trustee regulatory advice and guidance on matters of administration. It said that it would not conclude on public benefit issues, pending HMRC's determination of the Gift Aid claims. It noted that if it received new information or evidence, it might consider opening a new investigation. If trustees do not follow guidance from the Commission this can provide grounds for further regulatory action. However, the Commission decided it was not necessary to formally monitor the Trust after it closed its investigation.

Our conclusions on the Commission's investigation

2.27 The Commission's decision not to deregister the Trust on the grounds that it was a sham charity or was not in the jurisdiction appears reasonable, given the evidence available to it, and given that it had sought legal advice. However, its justifications for closing the case without further inquiring into and, if necessary, enforcing the proper administration of the Trust in accordance with charity law are weaker. In our view, there were issues that might have justified the opening of a statutory inquiry in 2011, to which the Commission did not give sufficient weight during its investigation. These issues are set out in paragraphs 2.28 to 2.34.

Scale of the scheme

2.28 The Commission did not give sufficient weight to the scale and nature of the scheme. Almost all of the funds that the Trust was going to give to charitable causes were to come from Gift Aid tax relief rather than the Trust's participants. HMRC had made clear in March 2010 that it did not consider this type of scheme could create an entitlement to tax relief for charities or individuals, and it has not paid the charity's or the individuals' Gift Aid claims.¹⁴ The amount of Gift Aid being reclaimed and the cost of the gilts purchased by the Trust to generate its income dwarfed the funds the Trust disbursed to charities.¹⁵ The Commission did raise these issues with the Trust as part of its investigation but appears not to have adequately taken these features into account when assessing whether the scheme was an appropriate activity for the Trust. It took the view that this is a tax matter for HMRC to deal with.

2.29 Although the Commission also considered, and raised with the Trustee, the potential public detriment given the diversion of funds from the Exchequer, it did not give sufficient weight to this issue in its considerations.

¹⁴ See source in footnote 5, paragraphs 34 to 35.

¹⁵ The Trust's annual accounts for April 2009 to March 2010 show income of £97,590,164 and costs of generating funds (that is, the purchase of gilts) of £97,451,195. The Trust made no grants to charitable causes that year.

Impact on public trust and confidence

2.30 The Commission did not adequately appreciate the potential impact of the case on public trust and confidence in charities. It did not appear to fully consider the detrimental effect of not opening a statutory inquiry on public trust in charities.

2.31 In regulatory cases of significant public interest, the Commission reports publicly on the key issues, findings and its conclusions. The Commission considered whether to publish a report on its investigation into the Trust in March 2012. It decided that the Trust was relatively unknown so there was no significant public interest in doing so. It also judged that public confidence in charities would not be enhanced by wider discussion of the issues.

Other issues

2.32 There are other issues that the Commission could have explored further. The first is the trustees' potential conflicts of interest. The Commission had several pieces of information that suggested a potential conflict of interest. It knew that Matthew Jenner promoted the scheme to the Trust while he was a director of the corporate Trustee. It also had information from the corporate Trustee's lawyers that Mr Jenner had received up front fees paid by participants in the scheme to HNW Tax Advice Partners (of which Mr Jenner was a partner). The Commission identified that potential conflicts of interest existed, but took the view that these had been managed because Mr Jenner resigned from the corporate Trustee at the times the decisions that the Trust should participate in the scheme were made.

2.33 The Commission relied on information provided either by Mr Jenner, acting on behalf of the corporate Trustee, or by the Trust's lawyers and it met Mr Jenner on two occasions (in July and December 2010). It made efforts to verify the information provided by Mr Jenner with other sources and tried a number of times to make contact with the other two directors of the corporate Trustee, but did not manage to meet or communicate with either of them directly before closing the investigation. In letters of August and October 2011 from the Trust's lawyers, the directors of the Trust offered to meet the Commission to discuss any continuing specific concerns.

2.34 The Trustee did not take independent legal advice on whether the scheme was an appropriate activity for the Trust, as a charity, to be involved with.¹⁶ Allowing the Trust to enter into the scheme without its own independent legal advice was potentially a breach of the Trustee's responsibility to the Trust.

¹⁶ The participants in the scheme did seek legal advice and had a QC's opinion that the scheme was lawful.

Part Three

Events since the investigation ended

3.1 This part of the report covers the events since March 2012 including the Committee of Public Accounts' (the Committee) hearing and the Charity Commission's (the Commission's) actions since the hearing.

3.2 Between closing its regulatory compliance case in March 2012 and February 2013, the Commission took no action on The Cup Trust (the Trust). In its letter of March 2012 to the Trust notifying it that it was closing its investigation, it had said that if it received new information or evidence, it might consider opening a new investigation. The Commission was also waiting for the outcome of HM Revenue & Customs' (HMRCs') determination of the Gift Aid claim.

Public Accounts Committee conclusions

3.3 On 31 January 2013, *The Times* and *The Mirror* newspapers reported details of the tax avoidance scheme that the Trust participated in and criticised the Commission's lack of action.

3.4 On 7 March 2013, the Committee held a hearing on the Trust attended by representatives of the Commission and HMRC. At the hearing the Committee strongly criticised the Commission's handling of the case. The Committee concluded that:

- the Trust did not meet the criteria for registration as a charity because it was not exclusively charitable and operating in the public interest;
- the Commission should have done more due diligence when registering the Trust;
- it had concerns that the Trust was not an isolated case; and
- the Commission's approach to regulation and enforcement lacks rigour.

The Committee recommended that the Commission should review whether it had investigated all potential similar cases to the Trust.

3.5 On 1 February 2013, the Commission's senior management took the decision that it was in the public interest to publish a regulatory case report. On the same day, it told the Trust of its intention to publish this report. At the hearing, the Commission told the Committee that it intended to publish the results of its investigation very soon, which at the time was correct. However, as it subsequently opened a statutory inquiry into the charity, the Commission could not publish its regulatory case report. It intends to report the results of its inquiry once it is concluded.

Commission actions after the hearing

3.6 In March 2013, the Commission sought further legal advice twice from counsel.

Opening a statutory inquiry

3.7 In a press release on 1 May 2013, the Commission announced that it had opened a statutory inquiry into the Trust "immediately following the receipt of new information from HMRC on 10 April 2013 about significant recent events". The trigger for the Commission opening an inquiry was that HMRC had given the Trust penalties for failing to respond to a request for information, which the Commission told us added to its own growing concerns. The Commission considered that this was evidence of Mountstar (PTC) Limited's (the corporate Trustee's) mismanagement.

3.8 The Commission's inquiry is considering:

- the Trust's Gift Aid claims including its ongoing engagement with HMRC;
- how the Trustee managed conflicts of interest, particularly in handling the Gift Aid claims;
- how the Trustee administered, governed and managed the charity and its involvement in the Gift Aid scheme; and
- whether the Trustee had complied with and fulfilled its duties and responsibilities as a trustee.

3.9 As part of the inquiry, the Commission appointed an independent interim manager on 26 April 2013 to control the Trust and its affairs. At this point the corporate Trustee ceased to have any ability or authority to act.

Trust's appeal to the First-tier Tribunal (Charity)

3.10 On 1 May 2013 the corporate Trustee applied to the First-tier Tribunal (Charity) (the Tribunal) to review the Commission's decisions to open an inquiry and appoint an interim manager. The Tribunal hearing took place between 10 September and 13 September 2013.

3.11 On 17 October 2013, the Tribunal issued its judgment rejecting both of the corporate Trustee's applications. The Tribunal found that when the decision to open the inquiry was taken in 2013, there was an overwhelming public interest in having a full and open inquiry and so it was a proportionate course of action. It found that there was no evidence that the Commission was acting improperly or unlawfully when deciding to open the inquiry and that it was both necessary and desirable to appoint an interim manager to protect the property of the Trust. The judge commented that the Commission's approach of disengaging with the charity in 2012 and letting HMRC investigate the scheme was an error. The judgment also said that to maintain public confidence in charities, the Commission needs to ask searching questions and cast a critical, sceptical eye over documentation to establish whether the substance is consistent with the legal form.

Other actions

3.12 Following the Committee's hearing on the Trust, the Commission reviewed its registration processes. It formalised its process of obtaining intelligence from HMRC before registering an organisation. It reviewed the application of its risk framework to registration cases, but concluded no major changes were necessary because it had been significantly reviewed and updated as part of the Commission's 2011 Strategic Review. It also reviewed whether there were any other charities on the register with characteristics similar to the Trust and reviewed its actions on charities identified by HMRC as being involved in tax avoidance schemes or fraud (**Figure 2**).

Figure 2

The Commission's review for other 'Cup Trusts'

HMRC told the Committee of Public Accounts' hearing that it knew of eight tax avoidance schemes involving charities, and that it investigated about 300 charities a year for fraud.

Tax avoidance schemes

HMRC confirmed to the Commission that of the eight disclosed tax avoidance schemes, only one involved a charity in England and Wales (The Cup Trust). The Commission's inquiry into the Trust is still ongoing and the Commission has confirmed that it will be publishing a report at the end of its inquiry. None of the remaining seven schemes involve charities in England and Wales and so the Commission has no jurisdiction over them.

Fraud in charities

The Commission also sought assurance and information from HMRC about the 300 cases that it told the Committee it investigates annually. These cases are possible fraud investigations and do not involve tax avoidance schemes similar to the Trust. HMRC gave the Commission information about relevant charities, including the names of 12 charities that it is investigating for possible criminal prosecution. The Commission has one inquiry and one operations compliance case into these charities. Three of these 12 charities are no longer registered.

Commission's review of the register

The Commission used three characteristics of the Trust to identify similar charities on the register. The characteristics were:

- low charitable expenditure as a proportion of total income;
- high cost of generating voluntary income as a percentage of the voluntary income generated; and
- a corporate trustee registered outside the UK.

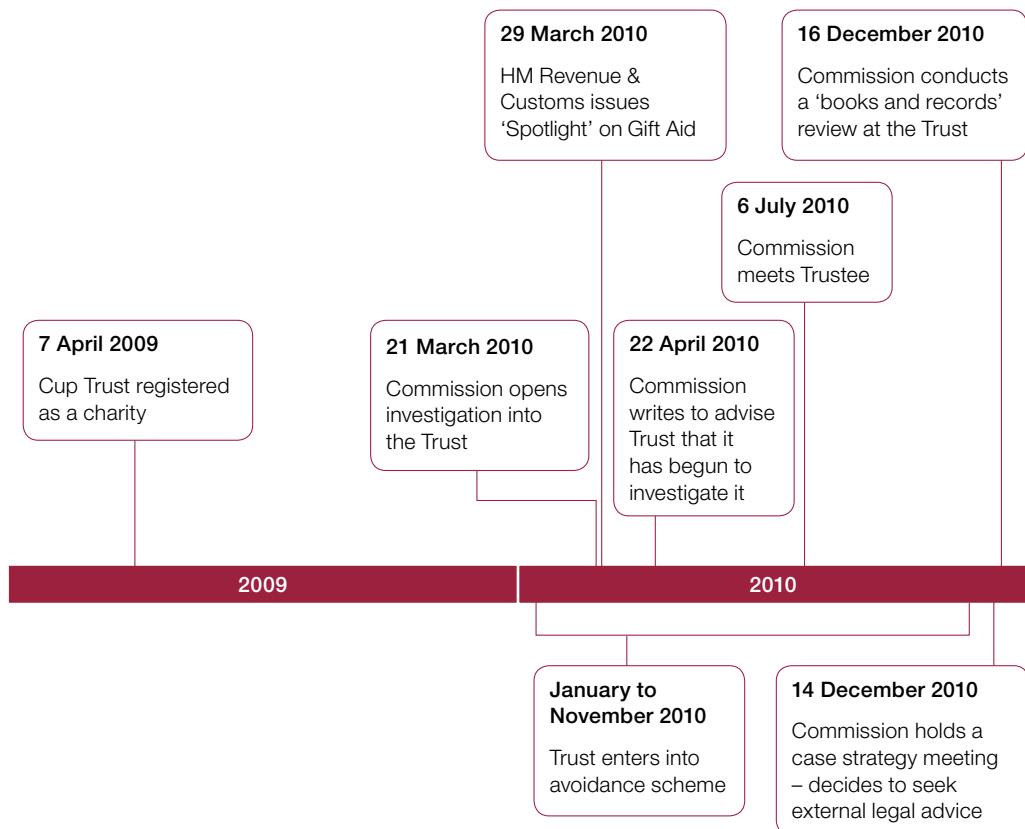
The Commission searched the accounts of charities with income of more than £500,000 to find charities with these characteristics, and looked into whether there were any indications of tax avoidance or other regulatory issues.

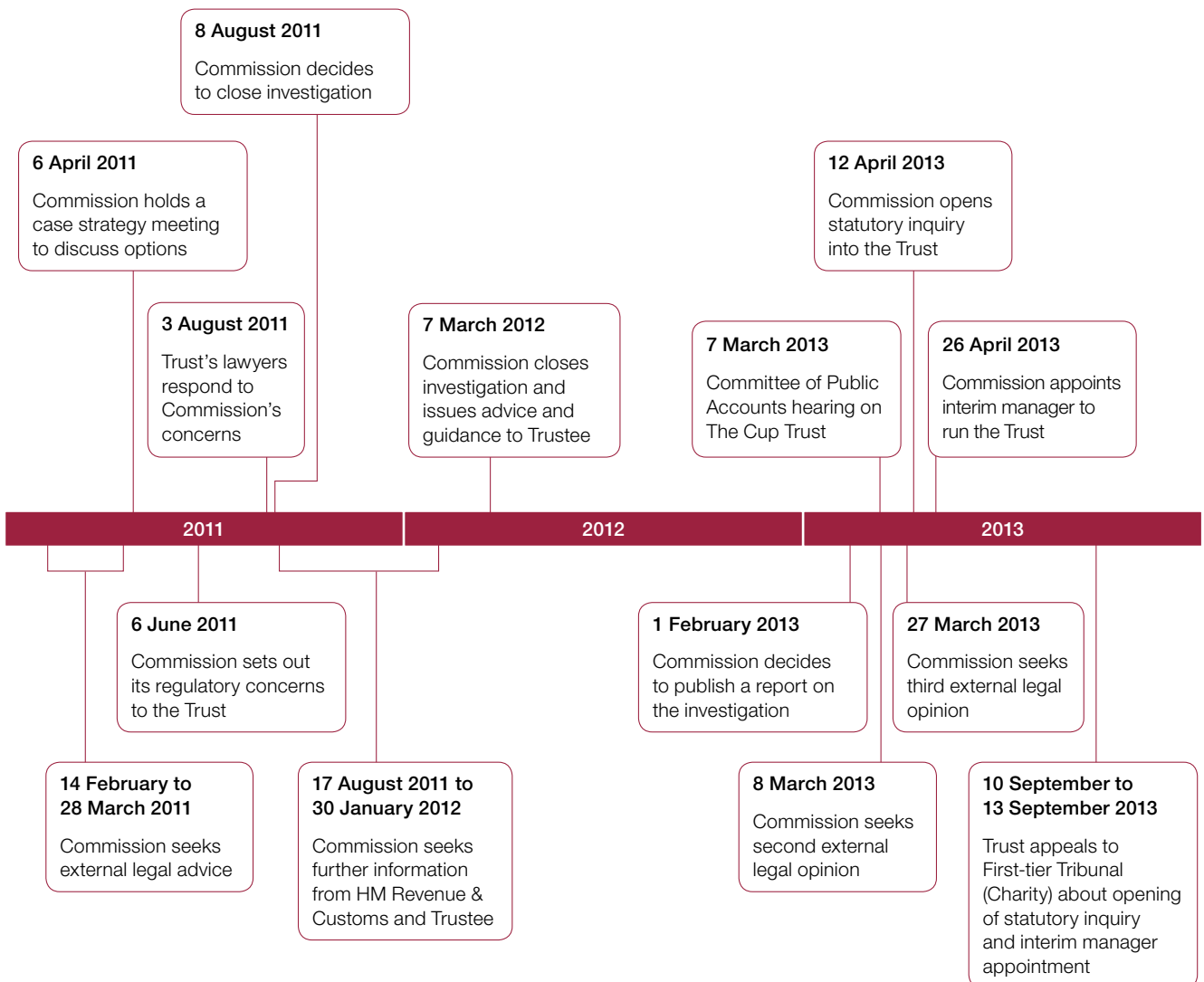
The Commission concluded that the Trust case was likely to be the only charity of its kind on the register. In the process it identified 13 charities to look into further and as a result it opened 13 operations compliance cases, of which three have now been closed.

Source: National Audit Office review of Commission papers and HM Treasury, *Treasury Minute, Government response on the Seventh Report from the Committee of Public Accounts Session 2013-14*, Cm 8697, September 2013

Appendix One

Timeline of events in the Commission's investigation







This report has been printed on Evolution Digital Satin and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.

Design and Production by
NAO Communications
DP Ref: 10299-001



National Audit Office

Published by TSO (The Stationery Office)
and available from:

Online
www.tsoshop.co.uk

Mail, telephone, fax and email
TSO
PO Box 29, Norwich NR3 1GN
Telephone orders/general enquiries: 0870 600 5522
Order through the Parliamentary Hotline
Lo-Call 0845 7 023474
Fax orders: 0870 600 5533
Email: customer.services@tso.co.uk
Textphone: 0870 240 3701

The Houses of Parliament Shop
12 Bridge Street, Parliament Square,
London SW1A 2JX
Telephone orders/general enquiries: 020 7219 3890
Fax orders: 020 7219 3866
Email: shop@parliament.uk
Internet: <http://www.shop.parliament.uk>

TSO@Blackwell and other accredited agents

£8.75

ISBN 978-0-10-298717-1



9 780102 987171
