

Law Commission Paper on Social Investment

Response by the Wellcome Trust

June 2014

Key Points

- We note the lack of practical case law and guidance in relation to charities making social investments, and welcome the Law Commission's review of social investment law. We are pleased to note the pragmatic approach taken by the Law Commission in the paper it has issued.
- We broadly agree that a statutory power to undertake social investment should be introduced. We also agree that there should be a review of the Charity Commission guidance CC14 — in some ways this will be inevitable if a new statutory power is introduced.
- We do not consider that a statutory checklist would be the best approach to take. Instead, non-statutory guidance would provide appropriate flexibility and ability to deal with a range of situations.
- In the event that a new statutory power is introduced, we would suggest that the Law Commission consults with HMRC prior to issuing such power. It is imperative that there are no inconsistencies between tax legislation and guidance and the charitable law in relation to social investment.
- Notwithstanding the current limits on its remit, we would urge the Law Commission to provide some clarification of the test under current law of what level of private benefit is acceptable.

Introduction

1. The Wellcome Trust is a global charitable foundation dedicated to achieving extraordinary improvements in human and animal health. We support the brightest minds in biomedical research and the medical humanities. Our breadth of support includes public engagement, education, and the application of research to improve health. We are independent of both political and commercial interests.
2. The Trust has been making programme-related investments (PRI) for over 10 years, particularly under our technology transfer award schemes, and has found this to be a useful tool in awarding funding to both charitable and for profit organisations. More recently, we have seen opportunities that offer both financial return and mission benefit, for example in early stage healthcare companies. While we have to date viewed these as either financial investment or charitable funding, we can see there may be opportunities that would best be justified by the combined financial and mission benefits.
3. We welcome the Law Commission's review of social investment law, and were pleased with the pragmatic approach taken in the consultation paper. We have not responded to the question relating to the use of permanent endowment to make social investments as this does not apply to the Wellcome Trust. However, we have made some additional comments at the end of our response which go beyond the consultation questions.

Current law and Charity Commission Guidance: CC14

4. In general, the Wellcome Trust has not felt restricted in making social investments by the current law. However, we recognise that our size makes it easier for us to access the necessary resources and to bear the risks that can be involved. We would therefore support anything that can be done to simplify the legal framework for the wider charitable sector. In many cases, however, the non-legal barriers — as identified in the Law Commission’s paper — may be more significant.
5. We regard the current version of CC14 as a positive step, and believe that the Charity Commission made a good attempt to provide some focus to an area where little case law and guidance existed. The process (and particularly the sections around ‘mixed motive investments’) clearly recognises that there is uncertainty in the law and suggests how best to approach some types of social investments.
6. We found the diagram on page 7 of the Law Commission’s paper particularly helpful in clarifying some of these issues, and suggest this could be incorporated into a review of CC14 as it clearly sets out the position faced by trustees when making decisions.
7. We would also welcome some clarity and agreement around the terminology of the various forms of ‘social investment’ which have been defined by the Commission in CC14. It may be that this would be a natural outcome of a specific statutory power and guidance relating to social investment. A broad definition should accommodate the evolving nature of social investment and the practical complexities faced by trustees in identifying risk around social investment opportunity.

The Social Investment Power and the proposed checklist

8. The introduction of a statutory social investment power is on the whole supported by the Wellcome Trust as it would make it clear to charities that this activity is permitted. We would agree that the power should apply unless it is expressly excluded in the governing documents of a charity. The statutory power should apply to all charities, regardless of their legal form.
9. Although we are generally supportive, it may be preferable to provide a general power to charities that enables them to take any actions that the trustees consider, in the proper exercise of their duties, would benefit the charity. This could be to directly further the charity’s purposes, or to obtain a financial return, or any combination of the two. It would then be a matter for the trustees to determine flexibly how best the charity’s funds can be applied at any time.
10. In relation to the proposed checklist, while we agree in principle with the considerations, we have some concerns with the concept of a list. Creating a statutory checklist risks creating new issues for trustees. For example, one of the proposed factors relates to the duration of the social investment. It is unclear if this would exclude or discourage social investments structured as equity investments where there is no clear duration (as is common in many early stage company investments). Although a checklist could be expressed as something that trustees “may” take into account, experience suggests that there would be pressure to treat it as a mandatory list of factors that would each need a positive evaluation.
11. Most charities will use far more of their resources in either direct activities or grant-making. No checklist exists in these areas and it is accepted that trustees will act in accordance with their core duties. We do not consider there to be anything inherently more risky about social investment that requires a specific checklist of factors to be considered.

12. Furthermore, a checklist could mean that trustees making decisions at the boundaries between social investment and grant-making, or social investment and investment, will inadvertently fail to comply with the formal requirements. This could form an additional barrier to charitable activity by chilling innovation.
13. We recognise, however, that it may be valuable to provide guidance, particularly in the early days of any new social investment power, and would welcome a provision for the Charity Commission to produce this. Such non-statutory guidance would also be simpler to update, and could therefore take account of changes in the social investment landscape.
14. In relation to the application of the Trustee Act investment duties, we agree that these should not apply to a social investment whether or not made under the statutory power. These duties may not be appropriate or relevant to social investments. However, we consider the boundary between social and financial investments is not entirely straightforward for this purpose, particularly where both a mission and a financial benefit are anticipated. Again, this supports our preference of non-statutory guidance as this could more easily accommodate the range of different situations and relevant considerations.

Other issues

Tax law and guidance

15. We would suggest that any review of the law of social investment and/or CC14 is undertaken in conjunction with a review of tax legislation and guidance.
16. The Law Commission's paper notes in paragraphs 6.6 to 6.10 that the legislation applicable to the taxation of charitable trusts (ss 521-563 Income Tax Act 2007) and that applicable to charitable companies and unincorporated associations (ss 466-517 Corporation Tax Act 2010) make specific provision for loans that are not made "by way of investment" (in s561 ITA and s514 CTA) but not for other forms of PRI.
17. It might be argued that such classification is not necessary because both such types of social investment can be treated as 'Type 12' investments as long as they can be shown to be for the benefit of the charity and not for the avoidance of tax. The term 'investments' is not defined in this context, but the origins of the legislation and the nature of the assets falling within Types 1 to 11 suggest that it was intended to be interpreted in its legal sense, i.e. that the asset concerned is expected to generate a positive financial return.
18. This is supported by previous editions of HMRC guidance on the subject which stated that an investment would normally be for the benefit of the charity "where it is made on sound commercial terms" — it is only in the latest 2013 edition of the guidance that HMRC has adopted a more flexible position that this condition can also be met where the investment is made for the "charitable benefit" of the charity.
19. If, however, PRIs that are not loans cannot be categorised as investments for these purposes, charities would have to rely on the expenditure being charitable on general principles that are comparable to grants and do not fall within any of the categories of non-charitable expenditure listed in s543 ITA and s496 CTA. This would be consistent with HMRC's current guidance at Annex III.4.11 of its website guidance notes.

20. As the law stands, it is difficult to see how genuine mixed motive investments can easily fit into this framework if they are neither investment in the legal sense (because they are not expected to generate a positive financial return) and they do not take the form of loans that are not made by way of investment. HMRC's suggested approach in Annex III.4.12 is based on the premise that the social element of a mixed motive investment has a value that is readily capable of measurement, which will not necessarily be the case.
21. It will also be important for charity accounting, as reflected in the soon to be issued Statement of Recommended Practice for Charities, to reflect the flexibility under the new law.

Public Benefit and Private Benefit

22. While we understand that the Law Commission's remit does not include a review of the rules relating to private benefit, this aspect of charity law generally plays an important part in the assessment of whether a particular social investment is appropriate for a charity.
23. It would be beneficial to provide some clarification of the test under current law of what level of private benefit is acceptable. The requirement in the Charity Commission's formulation that the private benefit must be "reasonable in amount" is particularly difficult to assess. We consider that this area should be addressed if the review is to succeed in its aim of reducing legal barriers to social investment by charities.

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