CSOs and the ‘Charity’ Model of Regulation
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A. INTRODUCTION

This paper considers the appropriateness of the English model of regulating CSOs, as exported across the common law world and beyond, which focuses almost exclusively on those CSOs that can meet the idiosyncratic requirements of the legal definition of charity. Specifically, it argues that there is a compelling reason to regulate the charitable sector on the basis that the activities carried on by charities in pursuit of their charitable purposes are beset by problems of information asymmetry between those who fund them and those who carry them out; this asymmetry warrants some form of state regulation so as to ensure the trustworthiness necessary for the effective operation of the sector. Effective regulation on this basis is provided by the charity law model of imposing trustee duties on those responsible for an organisation, coupled with supervision by a regulatory agency in the form of the Charity Commission. However, despite this, there are two fundamental flaws in the charity model. The first is that the similarities between charities and other, non-charitable CSOs outweigh the differences and, as such, a system of regulation that focuses on the former to the exclusion of the latter – the latter including campaign groups, political parties, social enterprises and co-operatives – lacks legitimacy. Despite their apparent diversity, charitable and non-charitable CSOs alike are engaged in activities that are characterized by problems of information asymmetry and as such merit a comparable regulatory response. The second flaw is that the consequences of charitable status, which comes in a one-size-fits-all package of ‘command and control’ regulation plus tax relief, are insufficiently sophisticated to deal with the different regulatory aims that ought to be our minds when determining whether a particular CSO is charitable, particularly given that the need to ensure trustworthiness is not the only concern for those charged with regulating organised civil society.

B. JUSTIFYING THE REGULATION OF THE CHARITABLE SECTOR

A CSO is charitable at law if it has exclusively charitable purposes and meets the ‘public benefit’ requirement, by which we mean that (a) the benefits of those purposes can be enjoyed by a sufficient section of the public and (b) those purposes do not generate more than incidental private benefit. The purposes that have been recognised as charitable over the centuries are diverse; it is not possible to draw up an exhaustive list but the following purposes have been held to be charitable by either the courts or Parliament:

- the prevention or relief of poverty
- the advancement of education
- the advancement of religion
- the advancement of health or the saving of lives

1 Not for citation. This paper draws together arguments developed by the author in The Regulation of Organised Civil Society (Hart 2009), Public Benefit in Charity Law (OUP 2013) and ‘The Fault Line in Charity’ in M Harding, A O’Connell and M Stewart (eds), Not for Profit Law: Theoretical and Comparative Perspectives (CUP 2014).

2 In England, thirteen of these purposes are now contained in the Charities Act 2011, s 3(1); the remainder are found in the common law.
• the advancement of citizenship or community development
• the advancement of the arts, culture, heritage or science
• the advancement of amateur sport
• the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
• the advancement of environmental protection or improvement
• the relief of those in need
• the advancement of animal welfare
• the promotion of the efficiency of the armed forces, or of the efficiency of the police, fire and rescue services or ambulance services
• the relief of rates and taxes
• the elimination of war
• the assistance of migration
• the promotion of public works and amenities
• the promotion of agriculture, industry and commerce
• the provision of social welfare through recreation.

Is there something about these apparently diverse purposes such that, when they are pursued in a way that meets the public benefit requirement, state regulation is justified? If so, is the justification one that is limited to these purposes, when pursued for the public benefit, such that it is appropriate to focus regulatory efforts on the charitable sector rather than wider organised civil society? The answer to the first question is yes; however, the answer to the second question is no.

1. Why regulate charities?

To answer the first question, let us consider the extent to which the diverse purposes listed above constitute a coherent subsector of CSOs. Certainly it is not difficult to make connections between individual purposes or sets of purposes, which is unsurprising given their analogical development. For example, the advancement the arts, culture, heritage and science can all reasonably be said to concern the advancement of education broadly conceived; the advancement of health or the saving of lives go to the relief of those in need; the advancement of conflict resolution or reconciliation sits comfortably alongside the elimination of war. However, it is much more difficult to discern a common thread that runs through each and every purpose. They do not, on the face of things, have very much in common beyond the fact that they happened to have been recognised as legally charitable – given that this traditionally required the court simply to proclaim that a purpose was ‘within the spirit and intendment’ of the Statute of Charitable Uses 1601, this tells us very little. Similarly, it is not immediately apparent that there is a

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3 Indeed, prior to the statutory codification in the Charities Act 2006 (and subsequently the Charities Act 2011) these purposes all fell under the second ‘head’ of charity at common law, the advancement of education broadly conceived: see eg Re Lopes [1931] 2 Ch 130 (Ch) (zoological society); Re Cranstoun [1932] 1 Ch 537 (Ch) (preservation of historic cottages); Re Spence [1938] Ch 96 (Ch) (museum of arms and antiques); Royal Choral Society v IRC [1943] 2 All ER 101 (CA) (choral society); Re Shaw’s WT [1952] Ch 163 (Ch) (promotion of bringing fine art to the masses); and many others.

4 The Preamble to the Act detailed a range of purposes considered charitable at the time: ‘the relief of aged, impotent and poor people ... maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities ... repair of bridges, ports, havens, causeways, churches, seabanks and highways ... education and preferment of orphans ... relief, stock or maintenance for houses of correction ... marriages of poor maids ... supportation, aid and help of young tradesmen, handicraftsmen and persons decayed ... relief or redemption of prisoners or captives, and
significant distinction between some of the purposes upheld as charitable and those rejected by the courts on the basis that they are apparently not within the spirit and intendment of 1601 Act: why are the reasonably close analogies between the advancement of amateur sport and the advancement of recreation, or between the advancement of human rights and the promotion of political purposes, not sufficient to render the latter charitable?

In fact it is one of the regulatory consequences of charitable status that points to an answer as to why it may be appropriate to treat certain bodies as charitable but not others on the basis of their charitable purpose and to regulate them collectively. That consequence is the imposition of trustee duties, and the mischief that these duties tackle, implicit in each of the otherwise diverse range of charitable purposes, is the information asymmetry inherent in their pursuit.

2. The information asymmetry in a charitable purpose

Every purpose recognized as being charitable can be justified as triggering a regulatory response by the state on the basis that each is characterized by a particular kind of information asymmetry between those who finance a service—i.e. donors and purchasers—and those who carry it out—i.e. charities—and, as such, they require a particular kind of trustworthiness in the bodies that provide them.\(^5\) This may be because they involve the provision of public goods or complex, intangible private services, or because they are premised on wealth redistribution.

Public goods

In the case of some purposes, information asymmetry arises because the beneficiaries of those purposes reach far beyond those who are funding them, such that it becomes impossible for the funders to evaluate the quality of service provision in any meaningful fashion.\(^6\) This kind of information asymmetry is intrinsic to certain charitable purposes as their pursuit amounts to the provision of public goods in the economic sense,\(^7\) that is to say those goods and services the cost of which does not depend on the number of beneficiaries and the benefits of which cannot be withheld from beneficiaries who free ride.\(^8\) The crucial characteristic here is the latter: because a public good is enjoyed by everyone, including those who do not contribute to its cost, the accurate evaluation of its overall benefit by those who do contribute is not

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feasible. The absence of meaningful evaluation leaves the provider of a public good with a strong incentive to abuse its position, for example through artificially inflating prices or reducing the quality of the public good,\(^9\) which in turn will dissuade potential donors from contributing for fear that their contributions will be misapplied. Of the charitable purposes listed above, six can only meaningfully be carried out in a manner that benefits all the members of the particular jurisdiction or region in which they are carried on and so are vulnerable to compromise in this way. These are: (1) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity; (2) the promotion of the efficiency of the armed forces, or of the efficiency of the police, fire and rescue services or ambulance services; (3) the relief of rates and taxes; (4) the elimination of war; (5) the promotion of public works and amenities; and (6) the promotion of agriculture, industry and commerce. In addition, (7) the advancement of environmental protection or improvement and (8) the advancement of animal welfare can fairly be considered public goods on the basis that their value lies in the benefit to mankind as a whole, as explained by Court of Appeal in Re Wedgwood:\(^{10}\)

A gift for the benefit and protection of animals tends to promote and encourage kindness towards them, to discourage cruelty, and to ameliorate the condition of the brute creation, and thus to stimulate humane and generous sentiments in man towards the lower animals, and by these means promote feelings of humanity and morality generally, repress brutality, and thus elevate the human race.

By their nature these indirect moral benefits extend to everyone and the cost of their pursuit is independent of the number of beneficiaries.

**Analogous private goods**

A second set of charitable purposes is characterized by their engagement with services that cannot easily be evaluated, not because they are public goods but because of their intangible or complex nature.\(^{11}\) These purposes include: (1) the advancement of education; (2) the advancement of health or the saving of lives; (3) the advancement of the arts, culture, heritage or science; (4) the provision of social welfare through recreation; (5) the advancement of religion; (6) the assistance of migration; (7) the advancement of citizenship or community development; and (8) the advancement of amateur sport. Difficulties of evaluation arise in the pursuit of these purposes because their benefits are unlikely to manifest fully except over an extended period, during which time there will be an information deficit (viz, the advancement of education, health and science; the provision of social welfare through recreation; the assistance of migration; the advancement of citizenship or community development; and the advancement of amateur sport), because the abstract or

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\(^{11}\) H Hansmann, ‘Economic Theories of Nonprofit Organization’ in Powell (n 5) 70–71; Hansmann, ‘The Role of the Nonprofit Enterprise’ (n 9) 30.
intangible nature of the purpose is such that we lack meaningful tools of assessment (viz, the advancement of religion\textsuperscript{12} or arts and culture), or both.

**Redistribution of wealth**

The remaining charitable purposes have comparable information asymmetry because they involve charities acting as intermediaries between funders and beneficiaries to give effect to wealth redistribution.\textsuperscript{13} In these cases, even if the beneficiaries of a service are able to evaluate its quality, they have no relationship with those who fund it other than through the charity and, as such, this information cannot easily be communicated. This problem may be exacerbated by some geographic or temporal distance between the funders and beneficiaries, which it is the purpose of the charity to bridge, as in the case of purposes that are carried on overseas, or at some future point in time after funding was provided, as with an endowment fund or where a charity has accumulated reserves.\textsuperscript{14} Additionally, as the beneficiaries of a charitable purpose will often constitute some of the more vulnerable members of society, it would be unrealistic to think that they will be in a position, or have any real incentive, to take any kind of active role in monitoring a charity’s activities. Two charitable purposes by their nature necessarily involve the redistribution of wealth—the relief of poverty and the relief of those in need—but any charitable purpose funded by way of donations or grants as opposed to, or in addition to, charging fees for service provision such will be exposed to problems of this nature.

3. **Imposition of command and control rules and oversight**

The information asymmetry that characterizes the purposes that fall inside the categories of charity justifies the regulation of organizations that pursue them,\textsuperscript{15} despite their otherwise distinct and diverse nature. It merits the collective imposition of prescriptive and proscriptive rules, and effective sanctions for their breach, to reduce the risk that those who carry on these purposes will abuse this asymmetry to the detriment of funders, beneficiaries and ultimately, society.\textsuperscript{16} In the charity law model of regulation this has traditionally taken the form of trustee duties imposed on those in control of charitable assets. In situations where the quality of service

\textsuperscript{12} Which, despite some variance across jurisdictions, is by definition concerned with spiritual rather than merely temporal matters: in England, common law position is that religion requires belief in a supreme being (\textit{R v Registrar General, ex parte Sedergal} [1970] 2 QB 697 (CA) 707 (Lord Denning MR)) and worship of that supreme being (\textit{Re South Place Ethical Society} [1980] 1 WLR 1565 (Ch)), amended by the Charities Act 2011, s 3(2) (a) to include belief in more than one god or none; in Scotland, religion 'encompasses faith and worship of one or many gods' (OSCR, \textit{Meeting the Charity Test: Guidance for Applicants and Existing Charities} (OSCR, Dundee, October 2008) 5); in Northern Ireland religion necessitates 'faith and worship of one god or more than one god or any analogous philosophical belief'; in Australia, religion involves belief in a supreme 'Being, Thing or Principle' (\textit{Church of the New Faith v Commissioner of Pay-Roll Tax (Victoria)} (1983) 154 CLR 120, 136 (Mason ACJ and Brennan J)) and relates to 'man’s nature and place in the universe and his relation to things supernatural' (1983) 154 CLR 120, 174 (Wilson and Dean JJ); in Canada religion 'typically involves … faith and worship [and] the belief in a divine, superhuman or controlling power' (\textit{Syndicat Northcrest v Amselem} [2004] 2 SCR 551, 000 (Iacobucci J)) although this is not a charity law case.


\textsuperscript{14} On which see C Mitchell, ‘Saving for a Rainy Day: Charity Reserves’ (2002) 8 CL & PR 35; Charity Commission, \textit{CC19: Charities’ Reserves} (Charity Commission 2010).

\textsuperscript{15} It may also merit the collective regulation, not just of charities, but of civil society organizations more broadly conceived, but this is another story: see J Garton, ‘The Legal Definition of Charity and the Regulation of Civil Society’ (2005) 16 KCLJ 29; Garton (n 5) ch 6.

\textsuperscript{16} As to the social value of a functioning third sector generally, see Garton (n 5) ch 3.
provision cannot be adequately evaluated, the duty not to distribute profit is significant as it removes the incentive on the part of trustees to compromise quality in order to divert assets to private hands; indeed, the problems of unchecked profit maximization are generally regarded as being the reason why for-profit firms do not dominate the various fields in which the charitable sector traditionally operates. This is not to say that the pursuit of profit is the only factor capable of distorting service quality, though, and a number of other trustee duties go towards ensuring that trustees do not succumb to maladministration or mismanagement. Thus, charity trustees must comply with all of the terms of their charity’s constitutional document, whether prescriptive or proscriptive. Where they have discretion they must exercise this only for proper purposes, and their fiduciary duty of loyalty requires that they take decisions solely in the best interests of the charity and not place themselves in a position where other interests may conflict, which in turn explains the various statutory restrictions on trustee remuneration. In several jurisdictions, charity trustees must also account for their stewardship of their charity’s property through the submission of annual accounts to a regulator. Other trustee duties are not concerned with preventing trustee maladministration but reduce the risk of compromised service quality by compelling trustees to adhere to certain operational norms, thus entitling potential funders to expect at least a minimum standard of care in situations where they are unable realistically to impose their own parameters of service and monitoring provisions. Charity trustees, like private trustees, are under a duty actively to participate in the management of the charity and can be held liable for the breaches of duty of fellow trustees if they fail to prevent them. They are under a positive duty to invest any assets held by the charity for the purpose of making money. Trustees must also exercise reasonable care and skill in the course of carrying out the duties of their office, which at least in England may take into account any special knowledge

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18 See the references listed above (n 5). This is not to say that it is wholly unviable for for-profit firms to operate in these fields, as there are various ways in which they can respond to perceptions of untrustworthiness, but their role is generally limited: see A Ortmann and M Schlesinger, ‘Trust, Repute and the Role of Non-Profit Enterprise’ (1997) 8 Voluntas 97.
19 A-G v Alford (1854) 4 De G M & G 843, 852; 43 ER 737, 741 (Lord Cranworth LC); Re St John the Evangelist (1889) 4 TLR 69; A-G v Trustees of the British Museum [2005] EWHC 1089 (Ch), [2005] Ch 397.
20 Re Beloved Wilkes’ Charity (1851) 3 Mac & G 440, 42 ER 330; St Mary and St Michael Parish Advisory Company Ltd v Westminster Roman Catholic Diocese Trustee [2006] EWHC 762 (Ch), [2006] WTLR 881.
21 Keech v Sandford (1726) Sel Cas Ch 61, 25 ER 223; Charity Commission, The Independence of Charities from the State (Charity Commission 2001); Decision on the Applications for Registration as a Charity by (i) Trafford Community Leisure Trust and (ii) Wigan Leisure and Culture Trust 21 April 2004.
22 Bray v Ford [1896] AC 44 (HL); Re French Protestant Hospital [1951] 1 Ch 567 (Ch).
24 See eg Charities and Trustee Investment (Scotland) Act 2005, Ch 6; Charities Act 2005 (New Zealand), ss 41–42; Charities Act (Northern Ireland) 2008, Pt 8; Charities Act 2009 (Ireland), Pt 3; Charities Act 2011 (England), Pt XIII.
25 Bahin v Hughes (1886) LR 31 Ch D 390 (CA).
27 Re Whiteley (1886) 33 Ch D 347 (CA); Trustee Act 2000 (England), s 1, sch 1.
or experience that they hold themselves out as having or ought reasonably to have by virtue of their position.\textsuperscript{28}

The information asymmetry inherent in the categories of charitable purposes merits an additional collective legal response on the basis that, unlike private trusts for individual beneficiaries (which attract a similar, though not identical, range of trustee duties), they raise distinctive problems of enforcement. The imposition of trustee duties can only be an effective remedy if the trustees who breach them are held to account, and it should be clear from the foregoing analysis that the information deficits that warrant the imposition of trustee duties are the same information deficits that prevent those who fund charities from easily identifying when breaches have occurred. For this reason it is important that, whenever a breach of duty does come to light, there are appropriate channels for remediating it regardless of when it is discovered and by whom. The common law traditionally provided this by entitling the Attorney-General to take legal action to protect the interests of any charity on behalf of the state,\textsuperscript{29} or at the request of a relator;\textsuperscript{30} in those jurisdictions that have adopted the English model, this is bolstered both by the powers given to charity regulators such as the Commission to investigate suspected breaches of trust,\textsuperscript{31} and by the standing given to appropriately ‘interested’ persons to seek remedial action in court.\textsuperscript{32}

**C. THE ILLUSORY DISTINCTION BETWEEN CHARITIES AND OTHER CSOS**

On the above basis it is possible to offer one credible reason for regulating the charitable sector. But what of those CSOs that do not meet the requirements of charitable status? Under the charity law model, non-charitable CSOs are not subject to systematic state regulation unless they happen to have adopted a particular organisational form (e.g. the company) or are engaged in a particular activity (e.g. social housing) that attracts the attention of a particular regulatory agency (in these examples, Companies House and the Homes and Communities Agency respectively). The supposed reason for focusing regulation on charities and ignoring other CSOs has been explained by the Prime Minister’s Strategy Unit as follows:\textsuperscript{33}

The regulation of charities as a specific class of non-for-profit organisation is justified by …

[1] The basic legal requirement that charities operate for public, not private benefit. [2] The fact that public confidence in charities derives from a knowledge that charities are altruistic in purpose … and the belief that there is regulatory oversight which will identify and deal robustly with misconduct and mismanagement.

The public benefit test is clearly a useful way of delineating between the private sector and organised civil society, as it excludes all organisations that operate on a for-profit basis. However, the test is under-inclusive, as the line around the charitable

\textsuperscript{28}Trustee Act 2000 (England), s 1(1).

\textsuperscript{29}Ware v Cumberlege (1855) 20 Beav 503, 52 ER 697; Re King [1917] 2 Ch 420 (Ch).

\textsuperscript{30}A-G v Vivian (1826) 1 Russ 226, 38 ER 88.

\textsuperscript{31}See eg Charities and Trustee Investment (Scotland) Act 2005, Ch 4; Charities Act 2005 (New Zealand), ss 50–61; Charities Act (Northern Ireland) 2008, Pts 5–6; Charities Act 2009 (Ireland), Pt 4; Charities Act 2011 (England), Pt 5; Charities and Not-for-profits Commission Act 2012 (Australia), s 20-5.


\textsuperscript{33}Prime Minister’s Strategy Unit, *Private Action, Public Benefit* (Cabinet Office 2002) para 7.1.
sector is drawn in such a way that many other CSOs are also excluded. First, it excludes those CSOs with certain objectives, such as political or recreational purposes: the courts have held that these objectives cannot be considered charitable purposes because they are not publicly beneficial in the ‘spirit and intention’ of the Statute of Elizabeth. Second, it excludes those CSOs with charitable purposes but which choose to pursue those objectives in a manner that involves a significant element of private benefit. Thus, social enterprises and mutual benefit organisations such as support networks, business associations and trade unions all fall outside the scope of charity, and, hence, outside the scope of sector-based regulation.

Yet if it is appropriate to regulate charities in order to deal with the information asymmetry that arises between donors and service providers, it is also appropriate to regulate other types of CSO in a similar manner, for they are just as susceptible (sometimes even more so) to information asymmetry, and for the same reasons. The need for some form of regulation to ensure trustworthiness arises whenever a service is provided in such as way as not to allow the immediate evaluation of its quality by those who fund it, and the three types of information asymmetry inherent in the activities of the charitable sector are in fact inherent in the activities of CSOs generally, whether charitable or otherwise. It is clear from the work of Weisbrod, Hansmann and others that CSOs operate successfully in certain social fields in no small part because they offer a greater degree of trustworthiness than for-profit firms, but it is equally clear that without some form of regulation this trustworthiness is susceptible to abuse.

It is noteworthy that it is generally the public benefit requirement, rather than the particular purposes pursued by a non-charitable CSO, that prevents such an organisation from attaining charitable status: the diverse (and non-exhaustive) nature of charitable purposes is such that, with the exception of political purposes, it is difficult to contemplate any significant area of civil society activity that could not be brought within a charitable purpose. Thus the key distinction between the charitable and the non-charitable is the presence or absence of private benefit; the distinction between the exclusively altruistic and the rest. The Prime Minister’s Strategy Unit has argued that the altruism resulting from the public benefit requirement means that ‘accountability in the charity sector can be less direct than that to shareholders and consumers in the private sector’. This is undoubtedly true: those CSOs which facilitate altruism are necessarily involved in the redistribution of wealth, where the natural position is one of information asymmetry. But any CSO which provides a public good or an analogous complex private good or service will generate information asymmetry, and so it is at least as important to regulate CSOs operating for mutual benefit or for a combination of public benefit and private profit, as it is to regulate those based on altruistic endeavour. Indeed, regulation may be even more pressing in these cases, as the presence of private benefit may operate as an additional corrupting influence.

CSOs with political purposes, which cannot be charitable regardless of whether or not they generate private benefit, also generate comparable information asymmetry to

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37 Prime Minister’s Strategy Unit, para 7.2.
those charities that pursue public goods. Political advocacy is quasi-public: any benefits that flow from the advocacy of a particular viewpoint or cause cannot be excluded from those who share the viewpoint or will profit from the cause but who do not contribute to the advocacy costs, and those advocacy costs ought to be unrelated to the number of people involved.\footnote{Although one can conceive of situations where it may cost more, not less, to advocate effectively the views of few rather than many, as those whose opinion it is hoped will be swayed may be more inclined to disregard views of held by few.} The nature of advocacy is also such that it will often be difficult to evaluate its successes and failures. If we wish to persuade the government to make a change in the law, lobby to that effect, and the change is made, it does not follow that our lobbying was causally significant; if the change is not made, it does not necessarily call into question the quality of our lobbying: unless we are given reasons for a particular government decision, we are reduced to guesswork. Where the aim of advocacy is to affect public opinion in general, sheer numbers render evaluation hopeless. For these reasons, political CSOs ought arguably to be regulated in a similar manner to charitable CSOs.

D. THE ONE-SIZE-FITS-ALL APPROACH TO CHARITY REGULATION

The above analysis took as its focus the correction of information asymmetry as a justification for regulating charities and, by extension, other CSOs. Of course this is but one justification: just as there is more than one type of market failure, so too is there more than one type of civil society ‘failure’ that might warrant some state regulation. In the final part of this paper I seek to argue (i) that different types of sector failure may require different regulatory techniques as a response; and (ii) that the imposition of one regulatory rule does not, in and of itself, justify the imposition of other regulatory rules, particularly where those different rules are best understood as responses to different kinds of sector failure. The English approach to civil society regulation ignores these premises and instead offers a one-size-fits-all package of regulatory rules for those civil society organisations that meet the legal definition of charity. This places an intolerable burden on the legal definition of charity, which is all that distinguishes the charitable from the non-charitable, and the regulated from the unregulated, within organised civil society in charity law jurisdictions.\footnote{See further J Garton, ‘The Legal Definition of Charity and the Regulation of Civil Society’ (2005) 16 King’s Law Journal 29.} I take as a jumping-off point the 2011 case of \textit{R (Independent Schools Council) v Charity Commission for England and Wales},\footnote{[2011] UKUT 421 (TCC), [2012] Ch 214.} in which the United Kingdom Upper Tribunal ruled on the continuing charitable status of independent, fee-paying schools, following the abolition in 2006 of a weak presumption at common law that CSOs which were for the advancement of education would also meet the public benefit requirement without the need for further argument or evidence.\footnote{Charities Act 2006, s 3(2); the relevant provision is now contained in the Charities Act 2011, s 4(2).} Independent schools have been recognised as charitable in law for several centuries, but in recent years have attracted considerable negative media attention for providing a benefit not to some cross-section of the public, or to the needy, but merely to the offspring of those affluent families who can afford their fees.

1. The Independent Schools Council case

In the \textit{Independent Schools Council} case, the Upper Tribunal was asked to determine an application for judicial review brought by the Independent Schools Council
challenging the correctness of the Charity Commission’s published guidance on the public benefit requirement, and to clarify a number of consequent questions regarding the charitable status of a hypothetical independent, fee-paying school raised by the Attorney-General. The guidance in question was published following the coming into force of the Charities Act 2006, under which the Commission was obliged to produce guidance to promote ‘awareness and understanding’ of the public benefit requirement for charities. At the heart of the judicial review action was the claim that the Commission had erred in law in making various statements to the effect that (i) a charity must not exclude the poor from the opportunity to benefit from its endeavours and (ii) a fee-charging civil society organisation is not charitable if it does not make reasonable provision for those unable to afford its fees to benefit from its services. The Attorney-General’s reference questioned the implications of these statements for independent schools, asking the Tribunal, inter alia, whether a school could be charitable if (i) its purpose is specifically to educate only those children whose families can afford to pay for the full cost of that education, or (ii) it carries out a more general educational purpose but only in return for fees that are beyond the financial reach of a ‘significant proportion of the population’. The Tribunal held that the Charity Commission was correct to state that a charity must not exclude the poor from the opportunity to benefit, but wrong to state that this required ‘reasonable’ provision to be made for the poor. Instead, the nature and extent of the provision is left the trustees’ discretion; the only benchmark is that it must go ‘beyond the merely de minimis or token’. Accordingly, it answered the Attorney-General’s questions in the negative. It held that a school that expressly restricted its purpose to advance only the education of those children whose families could afford to pay for the full cost of that education would not be charitable on the basis that to do so would necessarily exclude the poor, although it recognised that it would be unlikely that such a school would exist in reality. For the same reason, it also held that a school that charged fees beyond the reach of a significant proportion of the population would not be charitable if it was open only to those whose families could afford those fees. However, a school with a ‘not insignificant’ number of pupils whose fees are met through some charitable means, such as bursaries, could, depending on its individual circumstances, be charitable.

2. Charity and its Regulatory Consequences

How does the Independent Schools Council case sit in light of the analysis offered in the first part of this paper? Despite frequent misclassification as such, the education

42 The guidance in question comprised three publications: Charities and Public Benefit (January 2008); Public Benefit and Fee-Charging (December 2008); The Advancement of Education for the Public Benefit (December 2008).
43 Brought under the Charities Act 1993, s 2A(4)(b) and Sch 1D, para 4.
44 Charities Act 2006, s 4(4); the relevant provisions are now contained in the Charities Act 2011, ss 14. 17.
50 [2011] UKUT 421 (TCC), [2012] Ch 214 [177], [238].
provided by an independent school is not a public good in any meaningful sense. Its costs are not independent of the number of pupils it chooses to educate and it is a simple matter to limit its teaching to those who are able and willing to pay for it. Given that it would be unusual for a child to fund its own education, it might be argued that independent schools facilitate wealth redistribution between the children as beneficiaries and those who fund their education, but this would of course miss the point insofar as school fees will typically be met by parents or other relatives: trustworthiness only becomes an issue in the redistribution of wealth from donors to beneficiaries in circumstances where the former have no meaningful relationship with the latter. (However, this will certainly be the case whenever a school’s income is supplemented with alumnæ donations—and issues of trustworthiness will be aggravated in the case of endowed gifts where the capital is to remain intact, or testamentary gifts, where time as well as geography separates the donor and beneficiaries.)35 Rather, the education of schoolchildren is a complex service the quality of which will not fully emerge or otherwise become apparent until some point in the future.34 It cannot be adequately evaluated other than over a prolonged period, during which time it is essential that both those who fund and those who benefit are able to put their trust in those providing it. This is particularly true insofar as one of the goals of schooling is a child’s performance in national assessments (such as GCSEs and A levels) that are the culmination of several years’ teaching.

For these reasons it is prima facie appropriate to bring independent schools within the same regulatory framework—i.e. the charitable sector—as those other civil society organisations that operate with significant information asymmetry between those who fund and those who control them, and, because of this, require external oversight and the imposition of rules on the latter to enable them to function as a viable alternative to the for-profit market. On this basis, there is a sound justification for the charitable status of not-for-profit independent schools beyond mere precedent.

3. Beyond information asymmetry

However, the need to ensure that organised civil society is a trustworthy alternative to the private market is not the only justification for regulation. There is another, simpler, reason, particularly pertinent in the context of the global economic downturn following the 2008 financial crisis: the finite pool of funding available to the sector and the dual problems of what Lester Salamon terms ‘philanthropic insufficiency’ and ‘philanthropic particularism’.35 The former refers to the fact that organised civil society is never able to generate sufficient resources—whether from donations, grants or fee-charging—to meet the demands for every service that its constituent organisations would, in an ideal world, provide. This can in turn lead to the latter, where civil society organisations have an incentive—if only to preserve their own institutional stability—to gravitate towards carrying on only those ‘popular’ services that more easily attract a share of the limited resources which are available. With this in mind, another reason for regulation is the desirability of steering or shaping the

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33 As to trustworthiness and alumnæ donations, see Hansmann (n 9) 70.
34 See Garton (n 5) 50–51.
sector as a whole to encourage organisations to pursue socially valuable activities where otherwise they might not. 56 This is not, however, something that can effectively be achieved using the same regulatory tools that ensure the trustworthiness of charities, i.e. by imposing trustee duties and charging a regulatory agency with oversight of their compliance. A positive duty to carry on particular endeavours identified by the state, in particular ways, at the expense of others, would risk of creating an artificial—and likely significantly less effective—version of what we would prefer to see happen organically. 57 There are reasons for thinking that civil society organisations can be more efficient than the state when it comes to identifying social needs, 58 which is certainly borne out by the sector’s history of innovation; 59 such compulsion would also be anathema to the voluntary nature of civil society. Trustee duties are therefore generally better used to achieve regulatory goals that can be implemented by requiring voluntary bodies to refrain from certain activities, such as the distribution of private profit, rather than requiring them positively to perform certain activities. Certainly the trustee duties imposed on those responsible for charitable civil society organisations do not generally attempt to enforce positive, rather than negative obligations 60 —indeed, charity law generally leaves the implementation of a charity’s purposes to the discretion of trustees, and scrutiny of a charity’s activities is only permitted in certain limited situations: generally trustees are free to pursue whatever activities they think will best serve their charitable purposes. 61

For these reasons, if we wish to manipulate the sector so as to encourage certain socially desirable activities that might not be carried on sufficiently, or at all, in the absence of external regulation, it will be more sensible to use incentive rather than compulsion: rather than require compliance with rules and provide penalties for their breach, we can encourage desirable behaviour by rewarding those that voluntarily carry on a particular endeavour in a particular way. Unlike trustee duties, this form of regulation is particularly useful when it comes to philanthropic insufficiency or particularism: if we want more bodies to carry on a particular activity in a particular area or in a particular fashion, without compromising the sector’s voluntary nature, we can give them a choice: let them carry out whatever activities they see fit, but encourage them to pursue the chosen activity by granting them favourable tax conditions if they do. 62

This is, of course, exactly what happens when the state provides to charities favourable tax conditions that are not open to non-charitable civil society organisations, as is the case is many common law jurisdictions. Thus, despite the supposed reluctance of the court to take tax considerations into account when determining charitable status—a reluctance shared by the Upper Tribunal but

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56 See Garton (n 5) 108–9.
57 See Garton (n 5) 210.
58 Salamon in Ostrander and Langton (n 55) 39; E James, ‘Economic Theories of the Nonprofit Sector: A Comparative Perspective’ in H Anheier and W Seibel (eds), The Third Sector: Comparative Studes of Nonprofit Organisations (Walter de Gruyter 1990) 24; Garton (n 5) 57–9.
59 See Garton (n 5) 84–5.
60 Although there are exceptions, such as the duty of care.
61 As illustrated by the Upper Tribunal’s decision that it is for the trustees to decide how to ensure that appropriate provision is made for the poor where fee-chargin otherwise has the effect of excluding them from the opportunity to be beneficiaries: see above n 49 and associated text.
62 See Garton (n 5) 211-2.
belied by other authorities—this merits reconsideration of the decision in the Independent Schools Council case: if our regulatory concern is not trustworthiness but the appropriate allocation of limited resources across organised civil society then our conclusion may well be different. If the aim is to ensure that the beneficiaries of a charity are such that it is appropriate to grant tax relief, then it will be relevant to consider not just the nature of the purpose or the relationship between funders and beneficiaries, but also the nature of the class of potential beneficiaries. And of course the common law definition of charity does exactly this, requiring the courts and regulatory agencies to consider, depending on the charitable purpose in question, whether potential beneficiaries are ‘numerically negligible’ given the nature of the purpose, whether they ought more properly to be regarded as merely a private class, such as the members of a particular family or the employees of a particular company, and whether the class of beneficiaries is otherwise defined in a manner that we would not wish to encourage, such as by reference to arbitrary or discriminatory restrictions.

Each of these considerations ought to be relevant to any decision to grant tax relief, either because: (i) they point to the desirability or otherwise of encouraging a particular endeavour to be pursued in a particular way, such as for the benefit of an arbitrarily defined, discriminatory or unnecessarily exclusive class; (ii) they indicate something that we might reasonably expect will continue even without financial incentive, such as caring for one’s family members; or (iii) they indicate a private, commercial matter that ought to stand or fall on its own merit without state intervention, such as the benefits made available to the employees of a particular company. In the case of a school whose purpose is specifically to educate only those children whose families can afford to pay the full cost, or a school that charges fees beyond the reach of a significant section of the public and takes no steps to ameliorate this, as per the Attorney-General’s hypotheticals in the Independent Schools Council case, then the question of charitable status becomes a question of whether we think that educating the children of the well-heeled is a socially valuable activity and one which, because of philanthropic insufficiency, could not be carried on at an appropriate level in the absence of a favourable tax regime. It may well be that, if this is our primary regulatory concern, we would say that there are other more deserving calls on the public purse and these schools ought not to receive tax relief. If so, our conclusion may well be, as the Upper Tribunal held, that they do not merit charitable status.

4. Fundamental tension in the charity law model

See eg Re Compton [1945] Ch 123 (CA) 136–7 (Lord Greene MR); Neville Estates v Madden [1962] Ch 832 (Ch) 853 (Cross J); Re Pinion [1965] Ch 85 (CA) 101 (Russell LJ); Dingle v Turner [1972] AC 601 (HL) 624 (Lord Cross); Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue [1999] 1 SCR 123 (CA); Re Mills (deceased) [1981] 27 SASR 200 (South Australia SC).

Whether contrary to public policy at common law or prohibited by equality legislation: see further Garton (n 5) 144–7.

Ensuring trustworthiness and tackling resource insufficiency are both legitimate reasons for regulating civil society organisations. However, they are not mutually dependent: the need to attend to one does not necessitate the need to attend to the other. Further, they merit quite distinct regulatory strategies: the former requires robust rules to prevent maladministration and the abuse of power by those in control of an organisation, together with sanctions for their breach; the latter is better served by a softer approach based on encouragement rather than compulsion. Yet the English model of regulation is to apply a one-size-fits all approach to organised civil society—either an organisation meets the legal definition of charity or it does not. If it does, then those who control it become subject to all of the charity trustee duties that operate to reduce the effects of information asymmetry by minimising corruption and other challenges to trustworthiness, and the organisation also becomes eligible for tax relief. If it fails to meet the definition of charity, then neither will apply. The common law charity model does not allow for one form of regulation without the other, and this is exacerbated by the fact that most regulatory regimes—with the notable exception of Australia, where the Charities and Not-for-Profits Act 2012 lays the ground for future regulation of civil society organisations more broadly—focus systematic regulation on charities to the exclusion of wider civil society. Yet the need for command and control regulation is not peculiar to the charitable sector; it is just as relevant for those civil society organisations that operate with similar information asymmetry between funders and donors but which fall outside the definition of charity, such as social enterprises, co-operatives and political parties.

Challenges to trustworthiness are of concern for any body engaged in an activity where trust is important, e.g. any that is funded by donations. Neither is insufficiency of resources limited to those civil society endeavours that happen to fall within the definition of charity: the problem is universal. This is the tension that runs through the regulation of charity. The courts and regulators are required, when considering the definition of charity and its application to particular types of civil society organisation, to choose between competing regulatory goals that ought not to be competing at all because they are concerned with quite different problems.

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72 At the time of its implementation the Charities and Not-for-Profits Commission is charged with regulating charities and public benevolent institutions; the expectation is that its remit will in the future be extended to cover other, as yet undefined, categories of nonprofits.

73 See Garton (n 5) 176–84.