

Report for: LAC Limited

Prepared by: Keith Arrowsmith, Counterculture Partnership LLP

Date: 6 April 2018

Version: 3

counterculture



1 INTRODUCTION

- 1.1 Since the cancellation of the European Capital of Culture competition by the European Commission shortly before Christmas, Leeds City Council has been looking at the options for how it should continue the work it started on the Leeds bid to be European Capital of Culture in 2023.
- 1.2 Leeds City Council is retaining its financial commitment to delivering a festival in Leeds in 2023 to involve a 5 year lead-in period.
- 1.3 LAC Limited has been asked to consider:
 - 1.3.1 What is the right legally constituted vehicle for delivering the revised plans for Leeds 2023?
 - 1.3.2 What are the key issues we should base our decision on?
 - 1.3.3 What options do we have?
 - 1.3.4 What will be right for Leeds?
- 1.4 We are to consider the governance, legal and financial implications of how to take this work on Leeds 2023 forward successfully as a city-wide project, leveraging support and commitment from a number of partners for a high profile cultural project perceived to be of benefit to the whole city.
- 1.5 Some preparatory work has been completed, and you have supplied:
 - 1.5.1 The memorandum and articles of Leeds Culture Trust;
 - 1.5.2 Advice from Leeds City Council internal taxation and legal departments;
 - 1.5.3 An internal report Leeds City Council produced, outlining its original reasons for setting up Leeds Culture Trust.
- 1.6 An application for charity registration is about to be made.

2 LEEDS CULTURE TRUST

- 2.1 Companies House records confirm that Leeds Culture Trust (company number 10674601) was incorporated on 16 March 2017 (**LCT**).
- 2.2 Company House records show four trustees:
 - 2.2.1 Dinah Clark
 - 2.2.2 Kate Hainsworth
 - 2.2.3 Karen Sewell
 - 2.2.4 Barbara WoroncowAnd no person of significant control.
- 2.3 Its first accounts made up to 31 March 2018 are due to be filed by 16 December 2018 (presumably dormant) and its first annual confirmation statement of 15 March 2018 is due by 29 March 2018.
- 2.4 Its object clause is:

“To advance the Arts, Culture, Heritage and Creativity for the public benefit primarily but not exclusively in Leeds.”

We suggest that the object clause is reviewed before the application for charity registration is made:

- 2.4.1 ‘Culture’ is a broad term often used in the context of advancing art or heritage.
- 2.4.2 The advancement of art covers a wide range of charitable activity including: promoting various forms of art at a national/professional and local/amateur level; the provision of arts facilities; and encouraging high standards of art. ‘Art’ includes abstract, conceptual and performance art and representational and figurative art. Charities concerned with the advancement of art, whether visual arts or the performing arts such as music, dance and theatre, need to satisfy a criterion of merit.
- 2.4.3 ‘Heritage’ might be regarded as part of a country’s local or national history and traditions which are passed down through successive generations. Advancing heritage includes charities for the preservation of historic land and buildings. It might also include activities concerned with preserving or maintaining a particular tradition where the benefit to the public in preserving it can be shown.
- 2.4.4 “Creativity” is not a term that appears in the Charities Act 2011, which defines a charitable purpose, explicitly, as one that falls within 13 descriptions of purposes. It is our view that an application that includes “creativity” will be subject to a more stringent review by the Charity Commission.
- 2.4.5 The current wording does make it clear that LCT’s activities are for the public benefit.
- 2.4.6 The current wording does NOT limit the work of the charity to any geographic region. Instead it makes it clear that its activities will be “primarily but not exclusively in Leeds”. This would allow the trustees to sanction work in any other region of the United Kingdom or overseas.
- 2.4.7 By way of comparison, Hull City of Culture’s charitable objects are:

- (1) to advance the **education** of the general public in the arts and the artistic and cultural heritage of the city of Hull and in particular the arts of performance, music, drama, poetry reading, sculpture, painting, handicrafts and all other associated arts;
- (2) to **advance the arts** in particular the arts of performance, music, drama, poetry reading, sculpture, painting, handicrafts and all other associated arts, by encouraging public participation in the said arts and by the presentation of concert, performances, exhibitions and festivals provided that the promotion of such festivals and events is undertaken solely for the public benefit;
- (3) to **promote the arts and heritage** for the benefit of the public within the city of Hull in particular but not exclusively by supporting and representing the arts and heritage sector through promotion representation and development;
- (4) to further such other charitable purposes beneficial to the community consistent with objects (1) (2) and (3) above as the trustees shall in their absolute discretion determine.

- 2.5 This object clause shows that the organisation’s location is the focus, and helps stakeholders (including funders) to understand how it will operate by setting out its educational, artistic and community development aims.
- 2.6 We suggest that, given our recommendation to review the use of the word “creativity”, consent of the members of the charity is also sought to revise the charity’s object clause to something like the following:

For the public benefit primarily but not exclusively in Leeds:

- (1) to **advance the arts** in particular the arts of performance, music, drama, poetry reading, sculpture, painting, handicrafts and all other associated arts, by encouraging public participation in the said arts and by the presentation of concert, performances, exhibitions and festivals;
- (2) to **promote the arts and heritage** in particular but not exclusively by supporting and representing the arts and heritage sector through promotion, representation and development;
- (3) to advance the **education** of the general public in the arts and in particular but not exclusively the arts of performance, music, drama, poetry reading, sculpture, painting, handicrafts and all other associated arts;
- (4) to further such other charitable purposes beneficial to the public consistent with objects (1) (2) and (3) above as the trustees shall in their absolute discretion determine.

- 2.7 Any amendment made prior to an application for charitable registration only requires the consent of the charity's members (and subsequent filing at Companies House). Any amendment made after the charity registration will also require the prior consent of the Charity Commission.
- 2.8 The current constitution:
 - 2.8.1 Assumes at least 10 members (although it is not clear what should happen if this intention is not realised);
 - 2.8.2 Allows between three and nine trustees, one of whom must be a nominee of Leeds City Council. Trustees retire by rotation.
- 2.9 All charitable companies (and CIOs) are membership organisations, and the Charity Commission will expect its members and trustees to act in the best interests of the charity. The founder members of Leeds Cultural Trust were its four trustees.
- 2.10 Some charitable companies see a benefit in a wide voting membership base, with a smaller board that is appointed by that wider membership, since it creates an embedded level of check and balance.
- 2.11 Others see a wider membership base as costly to manage, and prefer that only trustees are appointed as voting members, and all voting members are trustees. This mechanism allows a simple governance structure which may well be appropriate in this case (and would seem to reflect the current situation). This could be embedded in the Leeds Cultural Trust's articles.
- 2.12 We see no benefit in stating an intended number of members.
- 2.13 There is a risk that, if the charity were to widen its membership base, that the costs of servicing the larger membership will become material, that some individuals and organisations may see their membership of this charity as a badge of honour, (or the lack of membership as shameful) or that the membership could never be a true and comprehensive representation of the diverse arts economy in the region.
- 2.14 We therefore suggest that the charity could remove this risk by altering its articles so that all voting members are trustees, and all trustees are voting members. Retirement from the trust board would automatically end the membership of the charity. If the charity wishes to engage with representatives of the arts community, it can do so by way of steering groups, sub-committees and supporter schemes.
- 2.15 We also recommend that the current trustee retirement provisions (three yearly retirement by rotation, no maximum term) are reviewed. It is our experience that this method of board retirement is falling out of fashion, since it is often misunderstood and forgotten, and is rarely a successful tool to encourage diversity of thought around the board table. Better succession planning can normally be achieved with fixed terms, typically of three or four years, renewable once or twice.

- 2.16 Given the charity's focus on events in 2023, there is an argument to say that the initial board should be in place until at least that date, and it would be beneficial to make sure that the whole board does not retire at the same time, so we recommend that if fixed terms are considered, then perhaps the initial trustees serve under a mix of fixed terms, of perhaps three, four and five years to stagger their retirement.
- 2.17 Some boards allow a trustee to return to the board after a break of at least a year. We do not recommend that mechanism, since we have found that trustees in that position often see themselves on sabbatical, with a right to return to the board. Instead, we recommend that the charity rely on its overriding power to alter its constitution if an unseen or unusual set of circumstances arise that means that it is in the best interests of the charity to allow a trustee to continue in office beyond a defined fixed term.

3 OTHER ALTERNATIVE STRUCTURES

- 3.1 LCT was set up as a not for profit company primarily to have a vehicle that would satisfy the requirements of the City of Culture competition. There is some benefit in continuing with the same structure (if nothing else, to make the best use of the current investment), but there may be some disadvantages in doing so.
- 3.2 There are three other structures that could be registered by the Charity Commission as charities:
- 3.2.1 An unincorporated association;
 - 3.2.2 A trust; or
 - 3.2.3 A charitable incorporated organisation.
- 3.3 The unincorporated association structure is best for informal groups or societies, where the members appoint a management committee to run the charity on their behalf. There is no independent legal body, and therefore all members are liable for the debts of the organisation, and committee members have to enter into contracts in their personal name on behalf of the other members.
- 3.4 Similarly, a trust has no independent legal status – but rather a body of trustees hold all assets on behalf of the beneficiaries and remain personally liable for the debts of the trust.
- 3.5 Given the scale of the funding, and the long-term nature of the project, we suspect that neither of these two structures will be appropriate.
- 3.6 The last alternative structure is a charitable incorporated organisation. This has the benefit of a separate legal personality, much like a charitable company, but without the dual registration and regulation by both the Charity Commission and Companies House. We therefore supply model constitutions for both charitable companies and for CIOs.
- 3.7 It is possible to convert a charitable company to a CIO at a later date if thought prudent.
- 3.8 Other structures – such as community interest companies – are not charitable, and community benefit societies (as known as registered societies, and previously as industrial and provident societies) could be charitable (but not registered with the Charity Commission as charities). It is our view that the legal structure that would be the most attractive to funders that has limited liability for its members would be either a charitable company or a charitable incorporated organisation. If the former, the existing company (with amendments to its current articles) would be a suitable vehicle.
- 3.9 Whether the project should continue to be delivered by a separate body, or whether it should be brought in house and run by Leeds City Council is considered further below.

4 CONTROL

- 4.1 There is some debate as to whether Leeds City Council should have a controlling or other interest in LCT:
- 4.1.1 Should it be able to nominate members?
 - 4.1.2 Should it be able to nominate trustees?
 - 4.1.3 Should its appointments allow a cross party representation?
 - 4.1.4 How should it deal with the inherent conflicts of interest?
 - 4.1.5 Is it in the spirit of collaboration for Leeds City Council (and only Leeds City Council) to have nomination powers? Should other supporters / funders have similar rights?
 - 4.1.6 Could Leeds City Council be able to achieve an acceptable level of comfort through its funding agreements instead?
- 4.2 Local Authorities are also subject to specific legislation designed to prevent public bodies circumventing governance controls. They are currently contained in Part V of the Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995 (S.I. 1995 No 849). These (among other things) regulate companies controlled by, or under the influence of, local authorities. The legislation was supposed to be updated in 2007, but we still wait for the new regulations to be brought into force.
- 4.3 For the purposes of the 1995 Order, a '**regulated company**' is a company **controlled by**, or **under the influence of**, a local authority and where, during any financial year:
- 4.3.1 The authority exerts a 'dominant influence' over the company (in the company law sense); and / or
 - 4.3.2 If it were a company the authority would be required to prepare group accounts in respect of the company in question.
- 4.4 A **controlled company** (per section 68 of the 1989 Act) is either:
- 4.4.1 A subsidiary of the local authority (per section 1159 of the Companies Act 2006); or
 - 4.4.2 Where the local authority controls the majority of the votes at the company's general meeting; or
 - 4.4.3 Where the authority has power to appoint or remove a majority of the company directors.
- There is no suggestion that LCT will be a controlled company.
- 4.5 An **influenced company** (under section 69 of the 1989 Act) is where a **business relationship** exists between the local authority and the company and either at least:
- 4.5.1 20% of voting rights are held by those **associated** with the local authority;
 - 4.5.2 20% of the company's directors are so associated, or
 - 4.5.3 20% of total voting rights at directors' meetings are held by people so associated.
- 4.6 **Associated persons** are specified in section 69(6). In summary, a person is associated with a local authority if he or she:
- 4.6.1 Is a member of the local authority or has been at any time in the previous four years; or
 - 4.6.2 Is an officer of the local authority; or
 - 4.6.3 Is employed by a local authority controlled company and is also a director, manager, secretary or similar officer of the company.

- 4.7 It has been suggested that three of ten board members will fall within the definition of Associated Persons, which amounts to over 20% of the total LCT board. This suggestion is on the basis that each of the political parties represented on Leeds City Council will have the right to nominate one trustee.
- 4.8 Therefore, if the local authority has a **business relationship** with LCT, it will be a local authority influenced company and regulated. A business relationship is defined in a variety of ways (section 69(3)) but the most likely to apply to LCT are where:
- 4.8.1 In any 12 month period, payments from the local authority or a local authority controlled company account for more than half of the organisation's income;
 - 4.8.2 Local authority capital grants or shares or stock owned by the local authority exceed more than half the net assets of the organisation;
 - 4.8.3 More than half the organisation's turnover is derived from assets in which the local authority has an interest; or
 - 4.8.4 The organisation occupies local authority land or buildings at less than market rent, or intends to enter into such an arrangement.
- 4.9 Payments from the local authority include grants of all types, fees for services provided under a service agreement or contract, or any other payment made by the local authority to the organisation.
- 4.10 Under a series of Directions made in 1995, exemptions from regulation were granted to area museum councils, regional or area arts boards, Groundwork trusts, building preservation trusts, Citizens Advice Bureaux, registered housing associations and companies which received less than £2,000 from the local authority in the previous year. It is possible for a new exemption to be applied for (although the costs and time scale are uncertain). It is also possible, in some specific circumstances for a local authority to pass a resolution stating that an organisation is not local authority controlled or influenced during a specified financial year. Among those criteria are:
- 4.10.1 The organisation does not receive any grants at all from the local authority during that financial year;
 - 4.10.2 The organisation pays full market rent during the year for any land it occupies in which the local authority has an interest; and
 - 4.10.3 The directors during the year are appointed for fixed terms of at least two years (section 68).
- 4.11 The appointment of non-voting members or observers does not make a company a regulated company.
- 4.12 Part II of the 1995 Order sets out the requirements for regulated companies. If LCT is regulated:
- 4.12.1 It must state on notepaper, emails, formal notices and other relevant documents, that it is an organisation that is influenced by Leeds City Council;
 - 4.12.2 Payments to LCT directors will be limited (but this is also the case due to LCT's charitable status). Note the ramifications for VAT Cultural Exemption below;
 - 4.12.3 LCT will be prevented from publishing material which Leeds City Council would be prevented from publishing;
 - 4.12.4 LCT would be required to provide information to Leeds City Council's members, its auditors and the Audit Commission;
 - 4.12.5 Audit Commission consent would be required for the appointment of LCT auditors;
 - 4.12.6 Leeds City Council would need to specify if its capital spending powers are reduced if LCT borrows money or receives some types of grant.
- 4.13 The most pertinent disadvantages for LCT in being a regulated company are:

- 4.13.1 The regulated company would need to declare the link, which may make collaborative working with other stakeholders harder to maintain;
 - 4.13.2 Funders may be unwilling to fund an organisation that is controlled by Leeds City Council (in much the same way that they would be unwilling to fund a local authority department);
 - 4.13.3 Purdah rules would be likely to apply, so that the operation of the organisation may be hampered in periods before elections;
 - 4.13.4 The costs of audit will be high; and
 - 4.13.5 The benefits of setting up an independent organisation in relation to reputational damage to Leeds City Council, and in relation to artistic independence, will be lost.
- 4.14 We recommend that the voting members of the charity are the trustees and vice versa. The current charity articles only give Leeds City Council the right to nominate one trustee. If our recommendation is followed, that one trustee will also be a voting member of the charity. That would mean that Leeds City Council would have the right to appoint one voting member, who automatically becomes a trustee of LCT. That person would be entitled to attend both general meetings and board meetings.
- 4.15 However, it also follows that if Leeds City Council only has the right to nominate one person, that one person could always be outvoted at a general meeting or board meeting. Increasing the number of nominated persons to a level that would mean that together they would have a controlling interest in the charity is possible under company law but would mean that the Charity Commission would probably decline to register the company as a charity (since it would lack independence).
- 4.16 If the number of nominations were to be increased to three, (to allow cross party support), then the number of positions that are not subject to nomination would need to increase (to satisfy the Commission that the charity was independent). If the aim is to ensure that the charity is not seen to be a local authority regulated body, then the total number of trustees appointed at any time would need to be 16 (i.e. 3 trustees of a total board of 16 amounts to 18.75% of the total, which is less than the 20% cap). It is our view that it may be difficult to quickly recruit sufficiently skilled, experienced and diverse candidates to fill such a large number of vacancies, and in any event, the resources required to manage such a large board may prove to be excessive in the longer term. We would expect to see a board for this type of organisation to consist of between 8 – 12 persons.
- 4.17 In order to reach the ideal board size, but remain independent, it would be necessary for the number of nominations from Leeds City Council to reduce to two.
- 4.18 Any nominee would be required to fulfil the Charity Commission requirements for charity trustees, and must be prepared to accept the obligations of being a company director and charity trustee.
- 4.19 However, we do not go as far as to recommend that a nomination process is entrenched in the charity's articles. We acknowledge that there may be benefits to the long-term relationship between Leeds City Council and the charity if Leeds City Council retains a right to nominate (although it is only a right, not an obligation to nominate). Those benefits may be outweighed if other stakeholders feel that they too should have a similar right. Comparative charities have granted similar rights of nomination to multiple local authorities and other stakeholders. That makes it more difficult to manage the board, and to achieve an acceptable mix of skills, experience and diversity. Instead, we suggest that Leeds City Council consider entrenching the right for it to have observer status at all meetings of the charity, and for all minutes of meetings to be made available to Leeds City Council. Such a right would allow Leeds City Council to receive relevant and timely information about the work of the charity, and for it to be in a position to offer assistance when required. This type of relationship is familiar to organisations funded by Arts Council England. The right could be entrenched in the charity's articles or in Leeds City Council's funding agreements.
- 4.20 Observer status may also assist when considering the potential for conflicts of interest.

5 CONFLICTS OF INTEREST

- 5.1 In order to achieve charity registration, it will be necessary to demonstrate how the inherent conflicts of interest that a local authority nominated trustee would face will be dealt with.
- 5.2 On the face of it, the nature of such conflicts of interest should be straightforward. They exist where a person has conflicting duties to two or more persons. Faced with such a situation, someone experiencing a substantive conflict must remove it by not taking part in the activity giving rise to that conflict. If s/he fails or is unable to do so, then that person is in breach of that duty – which may have professional, legal or even criminal consequences.
- 5.3 In the local authority situation, the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 (S.I. 2012 No. 2089) require that any declared conflict of interest in an executive decision be recorded as specified together with a note of dispensation granted by the relevant head of paid service.
- 5.4 As to companies, councils will often appoint their nominees as directors of companies in which their authorities are involved to ‘look after’ the authority’s interests and report back accordingly. There is clear potential for conflict here. While local authorities themselves have a fiduciary duty to their contributories, arguably their officers and members have an analogous duty to act in the best interests of their authority and the public interest generally. This is also enshrined in the seven principles of public life, namely: selflessness, integrity, objectivity, accountability, openness, honesty and leadership.
- 5.5 However, company directors and charity trustees also have their own range of fiduciary and other duties. These are specifically detailed in part 10A of the Companies Act 2006 (sections 171-177) and the Charities Act.
- 5.6 Section 175 of the Companies Act deals specifically with directors’ conflicts of interest. In particular, this provides (at section 175(1)) that a ‘director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company’. And by section 175(2) this ‘applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity)’. Furthermore, (by section 170 of the 2006 act) when a person ceases to be a director that person remains subject to the conflict of interest duty ‘as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director’.
- 5.7 If a director breaches any of these duties, section 178(1) provides that the consequences are ‘the same as would apply if the corresponding common law rule or equitable principle applied’. These duties are regarded as fiduciary. Section 178(2) states that (apart from the duty to exercise reasonable skill, care and diligence) these duties are ‘enforceable in the same way as any other fiduciary duty owed to a company by its directors’.
- 5.8 Local authority nominee directors therefore have a duty (at appointment and otherwise) to properly identify, manage and address any potential conflicts of interest. As Cabinet Office guidance indicates: ‘A failure to acknowledge and manage a conflict of interest could cause a significant reputational risk, may result in disqualification and have financial consequences for the director.’ It warns that ‘some conflicts can also have criminal implications’.
- 5.9 Therefore, local authority company directors will need at all times to remain alert to such conflicts, and when any potentially arise ensure that they take appropriate legal and other advice.
- 5.10 Under the latest Charity Commission guidance, a charity trustee must:
 - 5.10.1 “Do what you and your co-trustees (and no one else) decide will best enable the charity to carry out its purposes;

- 5.10.2 With your co-trustees, make balanced and adequately informed decisions, thinking about the long term as well as the short term;
 - 5.10.3 Avoid putting yourself in a position where your duty to your charity conflicts with your personal interests or loyalty to any other person or body;
 - 5.10.4 Not receive any benefit from the charity unless it is properly authorised and is clearly in the charity's interests; this also includes anyone who is financially connected to you, such as a partner, dependent child or business partner."
- 5.11 Therefore, charity trustees:
- 5.11.1 Each have an individual personal responsibility to declare conflicts of interest which affect them;
 - 5.11.2 Should have strong systems in place so that they are able to identify conflicts of interest;
 - 5.11.3 Must make their decisions only in the best interests of the charity. This means that they must consider the issue of the conflict of interest so that any potential effect on decision making is eliminated. How they do this will depend on the circumstances. In cases of serious conflicts of interest, it may mean the trustees deciding to remove the conflict by not pursuing a course of action, by proceeding with the issue in a different way so that a conflict of interest does not arise, or by not appointing a particular trustee or securing a trustee resignation;
 - 5.11.4 Where trustees have decided against removal of the conflict of interest, they must prevent it from affecting their decision in a different way. They must follow any specific requirements in the law or the charity's governing document which deal with conflicts of interest and how they should be managed (legal requirement); should, where there are no specific governing document or legal provisions, require conflicted trustees to declare their interest at an early stage and, in most cases, withdraw from relevant meetings, discussions, decision making and votes and consider updating their governing document to include provisions for dealing with conflicts of interest; and
 - 5.11.5 Should formally record any conflicts of interest and how they were handled and must, if they prepare accruals accounts, disclose any trustee benefits in the charity's accounts.
- 5.12 Further guidance is available from the Charity Commission (Ref CC29).

6 VAT

- 6.1 It goes without saying that VAT is complex, and what follows is a brief and simplified summary of the relevant issues.
- 6.2 As is the case with all charities, LCT will suffer some irrecoverable VAT because activities funded by grants, donations and legacies are non-business and therefore outside the scope of VAT. This means that the VAT on goods and services purchased to provide some or all of LCT's activities cannot be recovered.
- 6.3 If registered for VAT, it is likely that LCT will make non-business supplies and business supplies. This is known as mixed supplies. This means that LCT will only be able to recover input VAT on the portion used to make taxable supplies. The calculation of the portion will be either the HMRC standard method or a special method agreed with HMRC on a case by case basis. Once agreed, an annual adjustment is required at the end of the tax year which evens out variable exempt activity during the year.
- 6.4 It is our view that the method of calculation agreed between HMRC and other similar regional projects may give a useful steer, but only insofar as the activities of the organisation are similar to those expected of LTC. We work closely with a specialist VAT consultancy with an outstanding track record of dealing with similar cases.

- 6.5 Free admission to cultural facilities or activities is generally non-business as are voluntary donations from people who attend. Where an admission or similar fee is charged, it may be exempt, or standard rated depending on the nature of the organisation and its activities.
- 6.6 The non-recovered VAT becomes a cost to the charity. Those costs can be mitigated:
 - 6.6.1 There are some (not many) VAT reliefs for charities (including advertising, fundraising materials etc and some energy costs);
 - 6.6.2 Charities are exempt from VAT on admission charges, depending on whether it is managed and administered on a voluntary basis. VAT planning is therefore possible by opting into (or not opting into) the cultural exemption regime;
 - 6.6.3 If LCT is looking to deliver capital projects, then construction services for a new building can be zero rated, and some refurbishments, extensions and alterations are zero rated;
 - 6.6.4 Setting up a trading subsidiary, and considering whether the trading subsidiary is within or without a VAT tax group with LCT may assist (see Hull 2017 (Enterprises) Limited for example).
- 6.7 Which mitigating steps are most appropriate for the project will become clearer as the business plan develops. Suffice to say that at this stage, there is flexibility as to how the activities and funding could be structured to mitigate VAT concerns.

7 SECONDMENT AND STAFFING

- 7.1 Secondments would allow Leeds City Council, and other third parties to donate skills and experience to LCT. Alternatively, Leeds City Council could offer to provide services whereby staff are not seconded, but their services are provided in return for an agreed (reduced) fee.
- 7.2 Either arrangement would be treated as the supply of goods and services. If an employee is seconded to another organisation for no cost, or services are provided at nil cost, then there is no taxable supply, because no payment has been made. However, it is usual when an employee is seconded that a payment is received in return, and then there is a supply for VAT purposes (subject always to the local authority VAT scheme).
- 7.3 VAT is also not chargeable if:
 - 7.3.1 The secondment is between members of the same VAT group (for example, between LCT and its trading arm if they are part of a VAT group);
 - 7.3.2 The employee is jointly employed by the employer and the host charity;
 - 7.3.3 It is a VAT exempt service;
 - 7.3.4 If the secondment is between two not for profit voluntary organisations and the employee has been engaged only in the non-business activities of the lending organisation, has been seconded to assist in the same activities at the host organisation, and the host pays no more than the normal reimbursement costs of the employee; or
 - 7.3.5 The lending employer seconds a member of staff and the host exercises exclusive control over the staff member and is responsible for paying the employee directly (and meeting all third-party obligations such as NICs etc) then such payments are disregarded for VAT purposes. The concession will not apply if the lending organisation derives any financial gain from placing the employee with the host, or from any other arrangements or understandings between the lending organisation and the host.
- 7.4 Note that any other charges, for example for use of office facilities etc would still be subject to VAT.

8 CHAIR

- 8.1 The possibility of a paid Chair for LCT has been raised. Generally, charities cannot pay their trustees for simply being a trustee. It is only possible if it is allowed by the charity's governing document, by the Charity Commission or by the courts.
- 8.2 There is a general expectation that charity assets should be used directly for the purposes of the charity, and any departure from this position is only likely to be authorised by the Charity Commission in exceptional circumstances. When applying for charitable registration, the Commission will ask whether any trustees will receive payment and can deal with the situation as part of the application process, or a separate application for authorisation for payment can be made at a later date. In either case, it is likely that the trustees will need to fully justify the payments as being in the best interests of the charity, and that they are able to manage the risks involved in doing so.
- 8.3 The Commission states that it will normally only consent to a payment if the charity's complexity of operation will lead to an unusually high burden of trusteeship – with the trustee exercising a higher degree of responsibility and supervision in a complex field of activity. It is probably not sufficient to argue that the availability of payment for the Chair of LCT will overcome any difficulty in recruiting a chair. At the least, the Commission will expect LCT to have reviewed the effectiveness of its recruitment mechanisms.
- 8.4 The Commission's view is that simply paying legitimate reasonable expenses (in line with a written expenses policy) may well be sufficient in many cases. However, the Commission acknowledges that this may not be sufficient in some cases, especially where the potential loss of earnings is preventing promising candidates from applying.
- 8.5 To obtain Charity Commission consent, it will be necessary to:
 - 8.5.1 Show why LCT will not be as effective without payment – perhaps with evidence that it has made a serious attempt to recruit trustees on an unpaid basis;
 - 8.5.2 Confirm why there is a clear and significant advantage to the charity in paying the Chair rather than spreading duties among other trustees;
 - 8.5.3 Show whether the functions to be carried out by the Chair are genuinely those of a trustee, as distinct from functions of an employee or a consultant;
 - 8.5.4 Calculate whether the payment is reasonable and affordable, and will not affect the charity's ability to carry out its objects;
 - 8.5.5 Confirm whether any other trustee will receive benefits of any kind (other than expenses) directly or indirectly;
 - 8.5.6 Confirm whether the payment to the Chair will result in half or more than half of the trustee body receiving benefits;
 - 8.5.7 Confirm whether the unpaid trustees will be able to form a quorum to carry out the business of the charity without conflicted trustees;
 - 8.5.8 Confirm how the trustees have identified and managed all risks, including any conflict of interest, and how they will review performance (including how they will deal with poor performance); and
 - 8.5.9 Provide a copy of the LCT's accounts.
- 8.6 It is common for the Commission to ask for a benchmarking exercise to be carried out before consent is granted. In more unusual cases, the Commission has been known to ask for a consultation exercise to be completed with stakeholders.

9 MANAGING THE PROJECT IN HOUSE

- 9.1 The Leeds2023 entry to the 2023 European Capital of Culture required a lead applicant with its own legal governance and funding structure, to exist for at least two years. Some of the benefits of an independent body were expressed as:
- 9.1.1 “Delivering the bid through an independent company allows the authority to not become embroiled in [artistic] debates and (whilst controversy is not courted) allows for the artistic programme to be curated independently.”
 - 9.1.2 “An independent vehicle with strong links back to the authority would maximise our chances of success in terms of the delivery element of our proposal.”
 - 9.1.3 “Charitable status is also required to allow the project to apply to trusts and foundations and to certain Lottery programmes as part of the fundraising for delivery.”
- 9.2 We believe that those benefits still hold true.
- 9.3 We agree that LTC could operate as an independent vehicle, and a charity registration would make the organisation attractive to trusts and foundations. It would also allow live performances and exhibitions arranged by LTC to benefit from the creative tax reliefs (potentially covering 20% of production costs). We think it likely that the charity may well require a trading subsidiary to mitigate tax concerns.
- 9.4 Staying within local authority control also has its disadvantages – not least the pension scheme costs relating to employees, the reduced scope for third party financial support, and the lack of artistic independence.
- 9.5 Although we have not had the opportunity to complete a full scenario planning exercise, we suggest that it is highly likely that the advantages of the project being managed by LCT outweigh the advantages of the project being managed in house at Leeds City Council.

10 TIMELINE

- 10.1 If the project is to be run by an independent body, then the following time factors should be considered.
- 10.2 Any changes to the current constitution of LCT will require the consent of its current board and membership. Those resolutions could be passed by email.
- 10.3 The application for charity registration will take some time to prepare. It is more complex than normal because the Commission will be concerned about how LCT will:
- 10.3.1 Maintain a quality of artistic work;
 - 10.3.2 Be managed by a board with sufficient skills and experience;
 - 10.3.3 Be independent of the local authority;
 - 10.3.4 Justify payments to the Chair.
- 10.4 A standard registration for a new body will take approximately 12 weeks to be assigned to a case worker.
- 10.5 Most standard applications are dealt with in 16 weeks.
- 10.6 If the current company structure is used, then it has the advantage of its current company registration and being able to start to function albeit with charitable objects that are subject to Commission registration.
- 10.7 If a CIO structure is used, then it would not be possible to set up bank accounts, insurance, VAT registrations etc until the Commission approves the charity application.

- 10.8 As noted above, it is possible for a charitable company to convert to a CIO at any time. We therefore recommend that if Leeds City Council is prepared to fund an independent charity, then the current LCT structure is used, and that a conversion to a CIO structure is considered in the future, rather than winding up the LCT and setting up a new CIO.
- 10.9 Setting up a trading arm is relatively straightforward and can normally be achieved within a week.
- 10.10 That said, some further due diligence may be required to consider whether the trading arm should be part of a VAT group with LCT, and whether LCT should take any other measures to mitigate VAT.