

SRA BOARD
28 September 2020

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This paper will be published

Establishing SRA Limited as a charity

Purpose

- 1 This paper reflects on the discussion at the Board meeting on 15 September 2020 regarding the developments in the work plan to transfer the SRA's functions to a distinct legal entity SRA Ltd, and in particular the proposal to establish SRA Ltd as a charity. It addresses the purpose for doing so, and the complexities in practical and governance terms that may result.

Recommendation

- 2 The Board is asked to:
 - a) agree that we should move to establishing SRA Ltd as a registered charity, delivering the full range of regulatory and education functions of the SRA (including the SQE)
 - b) approve the charitable Articles of Association for SRA Ltd at annex 1, and to delegate to the Chair the agreement of minor changes.

If you have any questions about this paper please contact: Juliet Oliver, General Counsel, Juliet.oliver@sra.org.uk, 0207 621 3987

Equality, Diversity and Inclusion considerations

Consideration	Paragraph nos
This paper discusses requirements surrounding the vehicle delivering the Solicitors Qualification Examination which are key to ensuring that VAT liability on candidate fees is minimised, thus enhancing social mobility and diversity within the profession and in turn supporting access to justice for all communities.	Paragraph 14(c)
We consider it important that we can deliver our functions through a tax efficient vehicle to ensure sound stewardship of the funds that we levy from across the full diversity of the profession and firms.	Paragraph 14(c)

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Background

- 3 As Board members will be aware, following agreement in principle by The Law Society (TLS) Council last year, we have been working to establish the SRA as a corporate entity, as a wholly owned subsidiary of TLS but with a distinct and separate legal personality. The Board also agreed that we would establish a charitable subsidiary of that company, to deliver the Solicitors Qualifying Examination (SQE), in order to enable us to offer VAT exempt fees to solicitor candidates. We have established SRA Assessment Limited (SRAAL) to achieve that purpose.
- 4 As updated at the Board meeting on 15 September 2020, we have made good progress in relation to both workstreams, and are in a position to transfer the SRA's regulatory functions and associated assets to SRA Ltd for a start date of 1 November 2020, and to submit an application for registration for SRAAL to the Charity Commission in October.
- 5 We have agreed with the Law Society (TLS) that, prior to transferring the regulatory functions to SRA Ltd, we would obtain assurance over our tax status. The 15 September Board paper sets out the steps we have taken to do so and, in particular, to obtain non-statutory clearance from HMRC on the non-trading status of SRA Ltd and the reasons why this has not to date been satisfactorily resolved. The paper proposed as an alternative that we should seek to establish SRA Ltd as a charity, which would place it in a comparable tax position to non-trading status.
- 6 However, whilst this was the trigger for developing the proposal, when taking further advice on the option it became clear that there were a number of advantages of doing so, set out further below, that meant that members may consider this the preferable course of action in any event.

SRA Ltd as a charity

The nature of charities

- 7 Charities can be broadly defined as organisations that are established for charitable purposes only: namely, that fall within a loosely defined set of purposes set out in the Charities Act 2011. Critically, those purposes must be for public benefit, and this is key to the identity of charities as organisations that promote the public good.
- 8 In terms of charitable purposes, the Charities Act contains a catch all for any other purposes recognised as similar to those listed. This allows charitable purposes to be extended and developed as they have been by decisions of the courts and the Commission over the years by comparison with purposes originally held to be charitable. Examples given on the Charity Commission's website include: "promoting the sound administration of the law" and "the promotion of ethical standards of conduct and compliance with the law in the public and private sectors".
- 9 Charities therefore act as stewards of the funds they raise, all of which are held for and must be applied for the benefit of others. Their owners must not profit from their activities

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and they must comply with requirements designed to ensure they manage their resources advisably and account for their use.

- 10 To that end, charities are required to register with the Charity Commission which has powers to, for example refuse to register a charity or remove it from the register, agree/refuse changes to the charity's governing document, or disqualify/suspend a trustee. It exercises its powers with the aim of furthering certain statutory objectives, including to:
- a) Promote compliance with obligations relating to the management and control of charities.
 - b) Promote the effective use of charitable resources.
 - c) Enhance the accountability of charities to donors, beneficiaries and the general public.
- 11 There are approximately 170,000 registered charities in England and Wales. These include organisations ranging from museums and theatres, to international NGOs; private schools and universities, to those running services such as Which? Legal (a wholly owned subsidiary of the Consumer Association, which is a registered charity). They also include bodies with similar functions to the SRA, involved with the regulation and setting of educational standards for professions (such as the General Medical Council, Nursing & Midwifery Council, General Osteopathic Council, General Teaching Council of Scotland and The Chartered Institute of Taxation). Charities can be structured in a number of different ways, including charitable companies – eg companies limited by guarantee – trusts or unincorporated associations.

The SRA as a charity

- 12 We have taken advice from expert charity lawyers, as well as KPMG, on the feasibility of establishing the SRA as a charity and the advantages of doing so. This work commenced in early 2016 when we first started to consider, together with the Law Society, the possibility of establishing the SRA as a separate legal entity and highlighted that a charitable structure is aligned with the SRA's public interest role and statutory regulatory objectives. It also, through entrenchment of their objects and regulation by the Charity Commission, delivers enhanced independence and accountability.
- 13 We have been given clear advice therefore that an application to the Charity Commission for registration of our wider regulatory functions is likely to be strong. Our charitable purposes can broadly therefore be described as: *promoting the administration of the law and education and training in the law, through regulating solicitors and law firms to practice in England and Wales, and with the primary aim of protecting consumers of legal services and supporting the operation of the rule of law and the proper administration of justice.* With expert advice and assistance we therefore developed detailed charitable objects for the SRA, and these are set out in the draft articles attached at annex 1.

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Advantages of being a charity

- 14 There are a number of advantages therefore to the SRA moving to charitable status now. In summary:
- a) It allows us to take advantage of our new identity as a separate entity with our own legal personality through enhancing our accountability to the Charity Commission for the public interest nature of our role.
 - b) It strengthens our accountability - through compliance with Charity Statement of Recommended Practice (SORP) requirements in relation to our accounts - to the public, and profession by whom we are funded, for the way in which we use our funds.
 - c) It allows us to take the benefit of tax reliefs available to charities. Further details of the tax implications are set out in part one of annex 2 attached. This allows us to ensure that we are able to reduce the cost of the SQE for candidates by avoiding the need to add liability for VAT to the fees. It also allows us to maximise the use we can make of the funds available to us, enhancing the work we can do for the benefit of consumers of legal services – and reducing the cost of regulation for the firms and solicitors that fund our work.
 - d) It would provide clarity and certainty regarding the management of our tax position, thereby providing the necessary assurance to the Law Society.

Practical considerations flowing from charitable registration

- 15 Should we decide to pursue the option of establishing the SRA as a charity, there are a number of practicalities to consider. Members have raised detailed questions regarding the administration of the SRA as a charitable company. and we have considered carefully the issues raised and discussed these with our advisors. We have received reassurance that there are no significant issues or barriers. We set out here, however, some of the key considerations.

The legal and regulatory framework

- 16 We are of course used to meeting regulatory obligations from a number of bodies: as well as the Legal Services Board (LSB), we are subject to oversight from the Office for Professional Body Anti-Money Laundering in relation to our anti-money laundering work, and the Financial Conduct Authority in relation to our regulation of financial conduct - as well as working within the TLS assurance framework. Being a registered charity would mean that SRA Ltd will be subject to additional regulatory oversight by the Charity Commission. This raises the risk of duplication, as well as the possibility of conflict between our obligations under charity law and under the existing regulatory framework.
- 17 However, we have been advised that the Charity Commission's role and interest is of a different nature: it will not wish to interfere in our regulatory activities but will be concerned about any matters that impact on our charitable status (and for example, its handling of any complaints it may receive about the organisation will be limited in this way). Further, the key focus of the Charity Commission and LSB's regulatory activities will be aligned – to ensure that the organisation operates effectively in furtherance of its

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public interest purpose, which are in essence captured by the statutory regulatory objectives. We have raised the proposal with the LSB and do not currently foresee any issues, although we are presently in discussion with them. Should they raise any objection then we will update the Board accordingly.

- 18 We have considered the additional obligations or areas of oversight and are advised that these should not impact unduly or cause any great difficulty or conflict. We would need to comply on a continuing basis with various administrative requirements (most of these annual). These include compliance with statutory requirements as to:
- the keeping of records
 - the preparation of annual statements of account
 - the auditing or independent examination of accounts
 - the transmission of accounts to the Charity Commission
 - the transmission of an annual report to the Charity Commission.
- 19 There would also be a need to obtain Charity Commission approval for certain changes to its constitution/articles, and in terms of Board decision-making, there would be constraints around, for example, political activity or activity intending to confer private benefit on solicitors.
- 20 Should the Board agree to proceed down this route we will need to review and update some of our procedures although these should have a minor impact. In particular, we will need to comply on a continuing basis with requirements around record keeping and reporting on our accounts – and we will need to ensure that our accounts are completed in accordance with the relevant Statement of Recommended Practice (SORP). However we do not envisage this would have much impact on our current ways of working and our external auditors, BDO, have confirmed that this will cause no issues in terms of preparing consolidated Group accounts.

Trustees remuneration and liabilities

- 21 Trustees of a charity will also have additional fiduciary duties, complementary to their statutory duties as directors. If we proceed down this path, we will provide training for trustees. However, in summary, the six main charitable duties are:
- i. Ensure your charity is carrying out its purposes for the public benefit.
 - ii. Act in your charity's best interests.
 - iii. Manage your charity's resources responsibly.
 - iv. Act with reasonable care and skill.
 - v. Ensure your charity is accountable.
 - vi. Comply with your charity's governing document and the law.
- 22 The general rule is that trustees should not profit from their trusteeship. This creates a potential area of tension, given that members of the SRA Board are currently remunerated for their role and we would wish to maintain the current position.
- 23 However, Charity Commission guidance confirms that it is acceptable for trustees to be paid a reasonable amount for providing services to the charity. Although the Charity

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Commission prefers that no more than half of the trustees are remunerated, we have been advised that the current arrangement – where director/trustees are paid - would be acceptable to the Charity Commission if we can demonstrate that the levels of remuneration are in the best interests of the charity.

- 24 Therefore, we propose to deal with this in our application for registration, which will be able to set out the specific nature of the role and the need to have trustees with the necessary skills and experience, as well as our approach to setting and reviewing the levels of pay. This will show how we benchmark favourably against similar organisations which pay their trustees, such as the General Medical Council that makes honoraria payments which are greater than that which we currently pay our Board members.

Remuneration of executive directors

- 25 Another area to consider carefully is the remuneration of the executive team and CEO. This is not of direct concern to the Charity Commission, in that executive pay does not have to be approved by the Charity Commission and is ultimately a matter for the charity to decide. However, it does have an interest in the way in which resources are used and managed, and will wish to understand that the charity is as a whole being run appropriately and with sound financial prudence.
- 26 Therefore, as with trustee remuneration, we believe it would be prudent to set out in our application the requirements of the Chief Executive role and how we benchmark, set and review executive pay. There are many examples of charities who pay senior staff more than the SRA does.

Next steps and contingency planning

- 27 The Law Society is supportive of the direction of travel and are aligned with us in our goals of moving as swiftly as possible to an independent and tax efficient vehicle for our regulatory functions. TLS have provided minor drafting changes to the charitable articles – incorporated into the updated version attached at annex 1 – and have raised no substantive issues or concerns.
- 28 If the Board wishes SRA Ltd to proceed as a charity, then as sole member of SRA Ltd TLS will be required to approve and adopt the Articles. They would be looking to do so in the coming weeks. The Law Society are keen to progress the transfer of regulatory functions and propose to recommend to their board a 1 November 2020 date for go live in the meantime.
- 29 As stated previously, the establishment of a VAT eligible vehicle to deliver the SQE is time critical and will need to be in place by end June 2021 when fees for the first exam will start being collected. Members will recall the advice from leading counsel, that obtaining charitable registration would enhance our ability to satisfy HMRC that the company delivering SQE meets the VAT eligible body requirements. Registration with the Charity Commission is an iterative process which generally takes a number of months, although timescales are uncertain given the coronavirus pandemic. Therefore, whilst it can follow on from the transfer of functions, the application for registration of

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SRA Ltd would ideally need to be submitted as soon as possible and no later than late October/November.

- 30 Should the Board not agree the recommendations, we will bring contingency plans to the next meeting on 20 October 2020. Some initial considerations relating to the contingency plans are set out at part three of annex 2.

Recommendations: the Board is asked to:

- a) agree that we should move to establishing SRA Ltd as a registered charity, delivering the full range of regulatory and education functions of the SRA (including the SQE)
- b) approve the charitable Articles of Association for SRA Ltd at annex 1, and to delegate to the Chair the agreement of minor changes.

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Supporting information

Links to the Corporate Strategy and/or Business Plan

- 31 This paper relates to objective 3 in the corporate strategy as regards the delivery of an effective, tax efficient corporate vehicle: We will work better together, and with others, to improve our overall effectiveness, our responsiveness and the delivery of our regulatory functions.

How the issues support the regulatory objectives and best regulatory practice

- 32 The issues in this paper are aligned with the regulatory objectives in that charitable status supports accountability and is appropriately targeted on promoting the public good. Charitable status also supports the regulatory objectives to promote a diverse profession and to protect and promote the public interest.

Public/Consumer impact

- 33 A separate corporate vehicle will enhance confidence in the independence of regulation. Charitable status will ensure tax efficiencies that will be passed on to the beneficiaries including the consumers of legal services and aspiring solicitors. Achieving a VAT exempt vehicle to deliver the SQE will support the diversity of the profession which in turn supports access to justice for all communities.

What engagement approach has been used to inform the work and what further communication and engagement is needed

- 34 The issues in this paper have been discussed with the Separate Legal Entity Board working group.
- 35 We have engaged with the Law Society throughout this project and have raised with them the issues in this paper.

What equality and diversity considerations relate to this issue

- 36 The requirements surrounding the vehicle delivering the SQE are key to ensuring that we are able to minimise VAT liability for solicitor candidates, enhancing social mobility and diversity within the profession.
- 37 We consider it important that we can deliver our functions through a tax efficient vehicle to ensure sound stewardship of the funds that we levy from across the full diversity of the profession and firms.

How the work will be evaluated

- 38 There are no formal evaluation arrangements for the proposals in this paper. The working group will review progress on the proposals and updates will be provided to

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the Board in due course. In the event that we do secure charitable status our annual accounts and reporting will reflect the benefits realised.

Author **Juliet Oliver**

Contact Details Juliet.oliver@sra.org.uk

Date **18 September 2020**

Annexes

Annex 1: **Draft Charity Articles for SRA Ltd**

Annex 2: **Financial and practical implications and contingencies**

NB: annex 2 of this paper will not be published because it includes legal or other professional advice on sensitive or confidential matters.