

**OFFICE OF THE COMMISSIONER OF CHARITIES
GUIDANCE FOR
CHARITIES ENGAGING IN BUSINESS ACTIVITIES**

Purpose of Guidance

1 This Guidance serves to clarify when and how charities may engage in business activities. It also advises when business subsidiaries have to be set up to conduct such activities.

2 Some charities engage in business activities to generate additional income. Others may do so to provide goods or services for their members or clients. It is essential that these business activities do not undermine the charity's focus and distract the charity from its exclusively charitable purpose. Charity boards should also be prudent and must not expose their charitable assets to significant risk.

3 Where business activities may expose charitable assets to significant risk, they must be carried out by a business subsidiary. "Business subsidiary" means any non-charitable company owned by one or more charities to carry on a trade/business on their behalf. In this guidance, "business subsidiary" also includes a company which is co-owned by more than one charity or entity, even if it is not technically a "subsidiary" of any one of the charities which own it.

4 There must be an arms-length relationship between the parent charity and the subsidiary, such that the former's assets are protected from business risks and creditors. In addition, when making decisions related to a business subsidiary, the charity board must work in the best interests of the parent charity. This is because the main purpose of establishing a business subsidiary is to benefit the charity. Using charitable assets or putting them at risk for the benefit of the subsidiary would go against this purpose. In such cases, the charity board members may be personally liable for any loss in value of the charity's assets.

5 This guidance sets out the main principles applying to business activities conducted by charities, as well as to those conducted by their business subsidiaries. Ultimately, charity boards are responsible for the proper use of their charities' assets and resources, and are accountable for their investment decisions. However, if necessary, the Commissioner of Charities can direct a charity to cease funding or terminate its business activities, in order to protect its charitable assets.

Q1. What kind of activities can a charity carry out?

6 A charity should focus its efforts on carrying out its **primary purpose activities**. These are activities that contribute directly to the advancement of one or more of a charity's objects stated in its governing instrument. Examples of primary purpose activities are:

- a) Providing family counselling services at a fee by a family service centre which aims to help dysfunctional families;
- b) Selling artwork produced by disabled persons who are beneficiaries of the charity, or produced by elderly persons as part of their rehabilitation; and
- c) Selling tickets for an art exhibition by an arts charity.

Examples (a), (b) and (c) are considered primary purpose activities because these activities are all directly related to advancing the objects of the respective charities.

7 In addition, a charity may carry out **incidental activities** which support the advancement of its objects. Examples of incidental activities are:

- a) Selling vegetarian food in a Buddhist temple to promote and support the advancement of Buddhism;
- b) Selling drinks and snacks in a concert hall operated by a theatre charity, to provide convenience for theatre-goers and enhance the theatre-going experience; and
- c) Providing childcare services for a fee in a church, for parents who attend church services.

8 A charity may carry out **non-primary purpose activities**, but only if they have no material impact on the financials of the charity, and charitable assets are not exposed to significant risk. Non-primary purpose business activities do not directly advance or support the objects of the charity, and usually involve the provision of goods and/or services in return for income. They include business activities conducted solely for the purpose of generating income for the charities. However, a charity may carry out normal fund-raising events – these are not considered to be trading or business activities.

Q2. What is “significant risk”?

9 “Significant risk” refers to the potential use of a charity's resources to cover the losses incurred from investments or running a business activity. Donors and other stakeholders will expect charities to use their assets to further their charitable purposes, or to invest them prudently. A charity should thus consult its stakeholders before engaging in business activities.

10 When assessing the significance of the risk, the charity board should consider the following factors:

- a) Resources and future plans of the charity;
- b) Nature of the business, the charity's expertise in the business and the business environment; and
- c) Viability and sustainability of the business.

11 The assessment of risk will involve an element of judgment on the part of charity board members. A charity should consider seeking professional advice before engaging in business activities.

Q3. What is "material impact"?

12 An item of information has material impact if its misstatement or omission from the financial statements of a charity could influence the decisions that users make on the basis of these statements. Materiality depends on the size and nature of the misstatement or omission judged in the surrounding circumstances.

Q4. Can a charity invest its funds?

13 Charities with large reserves or endowment funds may invest their funds in financial instruments such as fixed deposits, equities and bonds to preserve the value of their funds or to generate income to support and further their charitable objects.

14 The charity board must ensure transparency in its investments and must not be distracted from its core charitable purposes. It will have to take into full account the potential risks and returns, and must not expose its charitable assets to significant risk.

Q5. When must a charity set up a separate legal entity i.e. business subsidiary, to carry out non-primary purpose business activities?

15 A charity wishing to engage in non-primary purpose business activities must set up a business subsidiary to undertake them. Exceptions may however be allowed for business activities which have no material impact on the financials of the charity, and which do not expose charitable assets to significant risk.

16 The subsidiary can be 100% owned by the charity but there must be an arms-length relationship between the charity and the subsidiary, such that the charity's assets are protected from the risks of the business and creditors. This will ensure that the charity's businesses are independent of its charitable activities and that charitable resources are protected from significant risk exposure.

17 A business subsidiary should become financially viable as soon as possible. It is important to have a business plan in place that clearly identifies the point at which the company is expected to be profitable. Progress should be assessed against the business plan. Where it is unlikely for the business subsidiary to become financially viable in the short to medium term e.g. within two years of operation, the

charity should carefully consider if it is still appropriate to undertake the planned business activity.

Q6. I want to set up an organisation which uses business activities as a means to further charitable purposes. Can my organisation be registered as a charity?

18 As long as your organisation is set up for exclusively charitable purposes and carries out activities (including business activities) to achieve these purposes, you must apply to register your organisation as a charity. However, if your organisation only carries out non-primary purpose business activities, you will not be able to register your organisation as a charity.

19 We recognise the following categories of charitable purposes:

- a) the relief of poverty;
- b) the advancement of education;
- c) the advancement of religion; and
- d) other purposes beneficial to the community. The following purposes are potentially charitable if they benefit the community:
 - i. the promotion of health;
 - ii. the advancement of citizenship or community development;
 - iii. the advancement of arts, heritage or science;
 - iv. the advancement of environmental protection or improvement;
 - v. the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantages;
 - vi. the advancement of animal welfare; and
 - vii. the advancement of sport, where the sport promotes health through physical skill and exertion.

Q7. My charity runs a social enterprise. Do I need to set up a separate legal entity i.e. business subsidiary to undertake the activities of the social enterprise?

20 If the charity or the social enterprise is engaging in primary purpose or incidental business activities, it does not need to set up a separate legal entity. However, a business subsidiary has to be set up to conduct non-primary purpose business activities.

Q8. What does the charity board have to take note of when investing or engaging in non-primary purpose business activities via a business subsidiary?

21 The Board of the parent charity must be able to justify financial support for a business subsidiary as an appropriate investment of the charity's resources. The interests of the charity must always be of top priority.

22 The Board must reasonably consider that it is in the charity's interests to make the investment, after comparing it against other possible alternative investments, and making an objective assessment of its business prospects. The Board must reasonably expect that the business subsidiary will be able to recover costs or make profits. The financial sustainability of the business subsidiary can be assessed based on its business plan, cash flow forecasts, turnover projections, risk analysis and other available information. The charity Board should also consider seeking professional advice before investing or engaging in business activities via a business subsidiary.

23 The charity Board must also regularly consider whether or not an existing investment should be retained or disposed of. It must actively monitor and review the performance of the subsidiary to ensure its relevance and viability, and whether it has achieved its objectives.

24 The charity Board must also ensure that business profits will be ploughed back to the charity and used solely to further its charitable purposes. They must not be used to further other non-charitable purposes or for personal gains.

Q9. Can a business subsidiary plough back its profits as donations, instead of dividends, to its parent charity?

25 The purpose of the subsidiary is to generate income for the parent charity to support its charitable work. Hence, the profits of the business subsidiary should be ploughed back to the charity or IPC in the form of dividends and not as donations.

Q10. Are charities liable to pay income tax on income derived from their activities as approved for the purpose of the Charities Act? Are business subsidiaries liable to pay income tax on their trading profits?

26 The income of all charities registered under the Charities Act is exempt from income tax. However, business subsidiaries that are set up by charities are treated in the same manner as any other company. The income of these business subsidiaries is subject to income tax.

Q11. Does a charity need to disclose information on its business subsidiary to the Charities Unit or the Sector Administrators?

27 All charities and Institutions of a Public Character (IPCs) are required to disclose information on their business subsidiaries according to the established

accounting standards. They are also required to keep the following documentation on their business subsidiaries, which the regulators may request for examination:

- The board's decisions and/or the discussions during the Annual General Meetings on matters relating to the business subsidiary;
- Rationale for having the business subsidiary;
- Trust deeds between the charity and its trustees as appointed directors of the business subsidiary;
- Amount of funds provided to the business subsidiary;
- Agreement/Contract between the charity and its business subsidiary, which should include information on how these funds are classified (e.g. as loans to the business subsidiary), the amount of interest being charged, and the re-payment schedule; and
- Amount of funds flowing out from and back to the charity.

Q12. Can charity board members and employees also work for the business subsidiary?

28 Charity board members and/or key employees of the parent charity may be board directors of the business subsidiary, to ensure that the latter is managed in the parent charity's best interest and achieving the outcomes set by the parent charity. However they have to bear in mind the principles of transparency and accountability, and ensure no conflict of interest in their roles.

29 Generally, charity board members should not receive remuneration for their Board/Director services. Where the charity's governing document permits remuneration of charity board members, the charity should disclose the remuneration and benefits, including any payment by the business subsidiary, received by each charity board member. The business subsidiary cannot be used as a way to pay the charity board members 'by the back door'.

Q13. Can a business subsidiary use its parent charity's facilities and resources?

30 Yes. However, the parent charity should charge for the use of its facilities and resources by the business subsidiary.

Q14. Can a charity write off loans to its business subsidiary or make further investments to fund its losses/deficits?

31 The charity board must always work in the best interest of the parent charity. The establishment of the business subsidiary is to enhance the value of the charity's assets, not to risk them.

32 Therefore, any write-off of loans or further investments in the business subsidiary must be properly justified, considered and approved by the charity board.

33 If the business subsidiary has been running at a loss for a significant time, the charity Board must consider the subsidiary's viability. The charity Board must minimise any losses to the charity, regardless of any sense of moral obligation the Board may feel towards the business subsidiary.

34 If the Board members sink further charity funds into supporting a business subsidiary at a time when it was reasonably clear that the failure of the subsidiary was likely, this may be a breach of trust on their part, putting them at personal risk to be personally liable for any consequential loss to the charity. The charity Board should consider seeking professional advice when faced with these circumstances.

35 A charity may fear that allowing a business subsidiary to go into insolvent liquidation would adversely affect the charity's reputation. However, this reason alone does not justify making a further investment, and/or retaining existing investments in the subsidiary.

36 Charities must thus be prepared to cease their business activities, or liquidate/sell the failed business subsidiary if it is dragging down the charity.

37 The board members/directors should also disclose the justifications for their decisions, the monitoring and review processes of the business subsidiary, and other relevant information, if queried by the regulators, its members or other stakeholders.

Q15. What are the possible outcomes if a charity decides to make further investments to fund the losses/deficits of the business activity or subsidiary, but is unable to recover the investments?

38 If the charity decides to make further investments to fund the losses/deficits of its business activity or subsidiary and is unable to recover the investments, the regulators can request information from the charity to assess whether the loss was incurred irresponsibly. The information requested may include the decision-making process of the charity, the details of the discussions and decisions made, and the board's explanations for the loss of money from the business activity or subsidiary.

39 Broadly, there are two possible outcomes, as follows:

- a) No breach of trust or failure in fiduciary duty by the charity board members if the decision to make further investments was made in good faith. However the Commissioner of Charities or the relevant Sector Administrator can make recommendations to the charity or issue directions that the charity has to comply with, in future undertakings.
- b) Possible breach of trust or failure in fiduciary duty by the charity board members, if there is reasonable evidence to show that they have acted irresponsibly. An inquiry can be launched to investigate the loss.

Q16. Under what circumstances will charities which are engaging in business activities be de-registered?

40 Charities are set up for exclusively charitable purposes. It is strictly prohibited for a registered charity to engage primarily in or to spend a significant amount of their resources on non-primary purpose business activities.

41 While it may not always be obvious that a charity has lost its focus on its charitable objectives, the following are some indicators that may suggest a charity has strayed from its charitable focus:

- The charity have given guarantees for the liabilities of its business subsidiary;
- The efforts of the charity board and employees are spent primarily on the non-charitable activities of the subsidiary;
- Where the charity and its subsidiary have consolidated their bank accounts, no proper records are being kept on the state of the balances on the individual accounts which have been consolidated;

Q17. Are charities/IPC's and their business subsidiaries subject to the Competition Act (Chapter 50B)?

42 Unless exempted, charities/IPC's and their subsidiaries which are engaging in economic activities are subject to the provisions of the Competition Act. They should be mindful not to engage in economic activities in an anti-competitive manner that could go against the Act. Examples of anti-competitive behaviour include price-fixing and market sharing agreements, and predatory behaviour to foreclose competitors.

Contact Us

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