

**Development Committee****08 September 2011****Shetland Development Trust (SDT) Surplus Distribution**

Report No: DV040-F

**Report Presented by Director of Development
Services****Development Services****1.0 Summary**

- 1.1 The purpose of this report is to ask the Development Committee to reverse a decision to distribute all Shetland Development Trust (SDT) profits (surpluses) to the Shetland Charitable Trust (SCT).
- 1.2 I propose that the Council, as sole trustee of the SDT, acting through the Development Committee play a more active part in the award of any undistributed and future surpluses. This will enable surpluses to be awarded to charitable bodies, which have an economic development benefit, commensurate with the Trust objectives.
- 1.3 Potential beneficiaries would be charities, which already receive funding from the Council. This would present an opportunity to reduce budgeted expenditure by using surpluses to provide the funding instead, subsequently resulting in a saving for the Council.

2.0 Decision Required

- 2.1 I recommend that the Development Committee, on behalf of the Council, as Trustee of the SDT, agree to:
 - 2.1.1 revoke the previous decision, minute reference 32/10, for the SCT to receive all the surpluses from the SDT;
 - 2.1.2 distribute surpluses directly to beneficiaries with an economic development objective, in accordance with the Trust Deed;
 - 2.1.3 await a further report(s) from the Director of Development Services with information on the level of available surplus for distribution, the sum in the tax pool and recommendations for potential beneficiaries.

3.0 Detail

3.1 Background

- 3.1.1 Surpluses are generated from the investments currently held by the SDT, mainly fishing quota, fishing vessel shareholdings and a loan book of some 75 loans, less the revenue costs of managing the portfolio.
- 3.1.2 A decision was taken at the Development Committee dated 29 April 2010, minute reference 32/10, for all undistributed and future surpluses generated by the SDT to be transferred to the SCT for their distribution to charitable bodies.
- 3.1.3 Since this decision was taken the only distribution made to the SCT was in May 2010 totalling approximately £350,000.
- 3.1.4 A decision was made by the SDT on 5 June 2008 to transfer all its staff, surplus cash and whitefish quota to the SIC. Since then the staff and surplus cash have transferred to the SIC but the quota remains within the SDT whilst the tax issues and management issues, associated with the asset transfer, are further clarified.

3.2 Current Surplus Position

- 3.2.1 Since the SDT is a Discretionary Trust it pays tax on its surpluses. However, this is currently under review by HMRC to seek an opinion if the taxable payments made since 2003 are appropriate. To date the taxable rate has been approximately 40% with different tax treatment on the source of income, i.e. loan interest, dividend and quota rental.
- 3.2.2 At present SDT's accounts have been prepared on the basis of the tax actually paid over to HMRC and have not been amended to take account of any revised tax position pending agreement with HMRC. This prudent position shows that the following are the SDT's accrued, undistributed, surpluses:
 - Financial Year 2009/10 approximately £523,000
 - Financial Year 2010/11 approximately £538,000 *

* provided by the SDT auditors, KPMG, on 29 August 2011, but is subject to a final audit.
- 3.2.3 Carried forward commitments for charity distribution total £4,150.
- 3.2.4 The SDT is currently managing out the portfolio of loan and equity investments made by the Trust up to June 2008 with all new investments made by the Council. Thus, SDT surpluses will steadily reduce and as new investments are made income to the SIC will increase. If the whitefish quota transfers to the SIC

the surpluses available for distribution will reduce further. However, the income to the Council will increase and, given the Council's status, is not taxable.

3.3 Proposal

- 3.3.1 It is proposed that surplus distributions will now be made from the SDT directly, rather than through the SCT. The Director of Development Services has notified the SCT of this proposal in writing.
- 3.3.2 Distributions will be made to beneficiaries, in accordance with the Trust Deed, at the Trustee's discretion. The Trust Deed states "The free income of the Trust, that is to say, the whole income of the Trust after deduction of any expenses properly chargeable to income shall be paid to such charitable body or bodies in the Shetland Islands as the Trustee in their sole and absolute discretion shall determine." This simply means that distributions can be made to Shetland based charitable bodies which can recover the tax paid by SDT on the distributions made to them.
- 3.3.3 Such distributions are treated as income in the hands of the beneficiaries. The income receipt for the beneficiaries is deemed to be received net of Trust rate tax (50% post 6 April 2010, 40% pre 6 April 2010).
- 3.3.4 As the beneficiaries are receiving this income net of tax it is necessary for the Trustee to have paid sufficient tax in the year of distribution/prior tax years to effectively "frank" the tax paid on the distributions made. The pool balance is increased annually when the Trust pays tax on its income and is reduced if distributions are made to beneficiaries. If the balance in the Trust pool is insufficient to "frank" the tax paid on a distribution to beneficiaries the Trustee will have a further tax charge to cover the shortfall, this is known as a "pool charge".
- 3.3.5 The tax pool as at 6 April 2010 was £1.1m, subject to HMRC confirmation. Since 5 April 2010 payments of £443,000 have been made reducing the pool to £667,000. As such, care should be taken when considering further distributions to ensure that the Trust does not incur an additional tax pool charge.
- 3.3.6 The SIC currently provides funding, through Service Level Agreements or Management Agreements, to several charitable bodies. Examples of these payments are made from the Economic Development Unit and SIC Grants Unit, to bodies such as the Shetland Fisheries Training Centre Trust t/a NAFC Marine Centre, Shetland Amenity Trust, etc.

4.0 Implications

4.1 Strategic

4.1.1 Delivery On Corporate Priorities – The proposal in this report fits with the Council's Corporate Plan 2010-2012, in particular Section 4: Organising Ourselves Better. If approved the outcome of this report will enable the maximum economic benefit from the disbursement of surplus funds to charitable bodies. In addition, this report proposes a way for the Council to find savings in this time of unprecedented cuts in spending. Surplus funding would be used to replace budgeted grant funding to charities with similar objects to the SDT.

4.1.2 Community /Stakeholder Issues – There could be an issue with amending the current Management Agreements or Service Level Agreements of beneficiary by amending their funding source. However, the Director of Development Services, or his nominee, will have full consultation with any beneficiary prior to a future report to Development Committee outlined in paragraph 2.3.

Policy And/Or Delegated Authority – The subject of this report complies with the Council's Economic Policy Statement 2007-2011. The Policy Statement was approved by the Development Committee on 24 April 2008 (02/08) and by the Council on 14 May 2008 (55/08).

In accordance with Section 2.3.1 of the Council's Scheme of Administration and Delegations, the Development Committee has delegated authority to implement decisions within its remit.

The Council's role as sole Trustee for Shetland Development Trust is deemed to fall within the performance of its development function.

4.1.3 Risk Management – Given that there is difficulty in the SDT providing funding to beneficiaries without applying conditions there is a risk that auditors find this unsatisfactory. The Council adopted the Code of Guidance on Funding External Bodies and Following the Public Pound in 1996. The object of the code was to ensure clear public accountability for public funds. The policy establishes clear procedures for Officers and Members of the Council to be followed when providing financial support to external organisations. Therefore it is essential that any beneficiaries have a similar objective to the SDT so that they generate economic development benefits to the Shetland economy without the need to apply detailed conditions. Great care will be taken to study potential beneficiaries objects to find organisations with matching objectives to the SDT. By doing this any risk of being found to be operating in a manner outwith the aforementioned guidance can be mitigated. Consultation with the Council's internal audit team will occur on this matter.

4.1.4 Equalities, Health And Human Rights – NONE

4.1.5 Environmental – NONE

4.2 Resources

4.2.1 Financial – The proposal in this report could create savings to the Council, as the surplus distribution from the SDT would replace current budgeted expenditure.

I recommend it would be good practice for there to be a time delay in any commitment to disburse surpluses to ensure appropriate beneficiaries are notified before a financial year end of any potential disbursement in the following year, for example:

Surplus from 2009/2010 should be disbursed during the financial year 2011/2012; Surpluses from 2010/2011 will be disbursed during the financial year 2012/2013, etc.

In real terms the surplus from 2009/2010 of £523,000 would be worth approximately £1,046,000 in total, including the tax rebate, to the nominated beneficiaries. This in theory could save the Council a similar amount in budgeted expenditure for the financial year 2011/2012.

It is noted that any surplus disbursement in any financial year should be limited to the surplus earned two years prior or to the value of the tax pool whichever is lower. This would eliminate any potential tax pool charge, see paragraph 3.3.4.

The tax situation with the SDT, as described in paragraph 3.2 is yet to be clarified with HRMC. Any tax bill, which would negatively impact on any surplus disbursement, as a result of cashflow difficulties, will be reported at the first opportunity to the Development Committee.

4.2.2 Legal – There may have been a risk in reversing the decision to give SCT the SDT surpluses for distribution to beneficiaries, especially if plans were made as to how the funds would be further distributed. However, the Director of Development Services has communicated the intentions of this report to the SCT and this does not appear to be an issue.

4.2.3 Human Resources – the administration related with surplus disbursement will be carried out by Economic Development Unit staff in conjunction with any other department of the Council currently providing grant funding to charitable organisation with economic objectives, i.e. the grants unit.

4.2.4 Assets And Property – NONE

5.0 Conclusion

- 5.1 This report concerns ensuring that SDT surpluses are used to the best advantage in Shetland's charitable organisations and the Council. There are a number of issues to be resolved including the level of surpluses available, the SDT tax position, ensuring compliance with following the public pound and identifying potential beneficiaries before a future detailed report can be presented to the Development Committee on this subject.

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31 August 2011

List of Appendices

Background documents:

[Report DV036-F, 29th April 2010](#), Arrangements for disposal of SDT Surplus
[Minute Reference 32/10](#).

[Report DV030-F, 05 June 2008](#), Transfer of Shetland Development Trust (SDT) Assets, and Staff Restructuring. [Minute Reference 13/08](#).