

Legal Structures

Under English law, charitable status is determined by an organisation's purposes rather than its constitutional form. A number of different legal structures are acceptable provided that all the basic conditions for charitable status are met.

The appropriate legal structure for an individual charity will depend very much on its actual and proposed activities and operations. Factors to be taken into consideration are:

- Number of staff to be employed
- Whether property is to be held
- Number and size of contracts to be taken on
- Whether the participation of a membership is desired
- Who is to exercise ultimate control.

As the choice of legal structure is of great importance, it is essential that the promoters should take advice at an early stage as to the appropriate structure.

Importance of choosing the right structure

Time taken in choosing the appropriate legal structure and drafting the governing instrument is never wasted. Failure to take care and time over this at the outset will frequently result in problems and additional legal costs at a later stage.

Organisations should look to the future: a structure which does not seem appropriate now may, in fact, be the most suitable in the long term. However, there are sound reasons why an organisation will wish to set up as say a trust, but if the operations of a charity expand or circumstances change in another way, it will usually be possible to change to become a company limited by guarantee. In many cases, though, this will be a time consuming exercise and involve an application to the Charity Commission and require the registration of a new charity.

Once the structure has been chosen a governing document should be drawn up. This must be drafted with care.

- The objects must be exclusively charitable in the legal sense of the word and wide enough to cover present and future activities.
- The administrative provisions must comply with charity law and be both comprehensive and flexible.

It is important that the provisions should cover all eventualities that can be foreseen but there must be an effective amendments procedure so that changed circumstances can be addressed. It is often advisable to keep much of the administrative detail off the face of the main governing instrument and in subsidiary rules so that changes can be more easily effected through issuing standing orders or bye-laws.

Types of structure

The form of a charity can be incorporated or unincorporated. The three most common legal structures for a charity are:

- Trust
- Unincorporated Association
- Company Limited by Guarantee.

Recent Government proposals have identified the need for a specific charitable incorporated organisation and this structure is also discussed.

Incorporation as a company will entail a degree of administrative burden at the time of establishing the charity and compliance with ongoing obligations. However, the major advantage of incorporating a company is that the liability of the trustees will be limited to a nominal amount.

The Friendly Society and the Industrial and Provident Society are also appropriate in some circumstances. These bodies, which are registered with the Registrar of Friendly Societies, are exempt charities and therefore not subject to registration with the Charity Commission. Other charities are established by Royal Charter or Act of Parliament. We do not consider these further in this note.

Unincorporated structures

The Trust

This is the traditional structure for a charity sometimes referred to as a "self-perpetuating oligarchy". A trust is essentially a relationship between three parties - the donors of the property or money, the trustees who hold the assets and the beneficiaries. It is a structure used both for private trusts, and with charitable objects, for charities. The governing instrument is the Trust Deed or Declaration of Trust signed by all the trustees. A trust is suitable where the active participation of a membership is not required. There will normally be a small number of trustees who both hold the assets and administer the trust funds. The trustees are subject to the supervision of the Charity Commissioners but are not accountable to any other body. Under common law the majority of trustees of a trust need to be based in Great Britain in order for the trust to be able to obtain charitable status.

A trust can be relatively quick and easy to set up and cheap to run as there are few statutory requirements. Provisions - other than the objects, the winding up and dissolution clauses - can be easily amended without recourse to the Charity Commission, by Supplementary Deed if the original Trust Deed has an amendments clause.

The trust is used in a wide variety of situations ranging from church restoration funds to the provision of medical equipment for disabled children. The main advantage of the trust is its flexibility which allows the trustees to get things done with the minimum of bureaucratic delay.

The main disadvantage of a trust is that being unincorporated it does not have a separate legal entity and the trustees must themselves own property and enter into contracts. The trustees are therefore jointly and severally liable if the charity is sued or incurs liability.

Although the trustees can be indemnified against the trust property, where liability is incurred in the proper administration of the trust, the trust property may not be enough to cover the liability. In this event, the trustees are liable to pay the debt themselves. This can of course result in the personal bankruptcy of the individual trustees.

Unincorporated Association

The Unincorporated Association is a very informal structure and is generally used for organisations which require the participation of members with a minimum of statutory obligations. It can be cheap to set up and run but is not suitable for a charity employing a number of staff or engaging in substantial contracts, primarily because, as with the trust, the members will be personally liable if the charity is sued or incurs liability.

It usually operates as a two tier structure. The management and administration is carried out by an executive or management committee and this committee is accountable to the members who meet once or twice a year in general meetings. The committee will often be elected by the membership at the Annual General Meeting but they can also be appointed or co-opted. The committee members are the charity trustees and legally responsible for the administration of the Charity.

As the Unincorporated Association has no separate legal identity, trustees must be appointed to hold property, especially land and investments. These trustees, known as holding or custodian trustees (not to be confused with the charity trustees), can be individuals, a trust corporation or, in the case of land, the Official Custodian. Again, the majority of members of the Unincorporated Association need to be based in Great Britain in order to be able to obtain charitable status.

The governing instrument of an Unincorporated Association is the constitution or set of rules. Although it is wise to base this on an agreed precedent it can be adapted to cover a wide variety of ways of working. It is particularly important that the constitution and any subsidiary standing orders should contain adequate administrative provisions and rules of procedure to avoid unnecessary internal disputes.

The Unincorporated Association is used for a wide variety of bodies and is particularly suited to organisations whose administration will be very simple. Unincorporated Associations are often local or community organisations such as village halls or parent teacher associations but some national membership bodies are also constituted in this way.

Incorporation

Charitable Trustees Incorporation Act 1872

The *Charities Act 1993* amended and revived the *Charitable Trustees Incorporation Act 1872*. Under the 1872 Act charity trustees may apply to the Commissioners to become incorporated. This does not create a new legal structure, but the incorporated body of trustees has legal personality. It can thus hold property, enter into contracts, sue and be sued.

In the past this procedure has been little used but the *Charities Act 1993* introduced a power of dissolution and simplified the procedure so that it is likely there will be a new demand for it in the future. The procedure can be used for all unincorporated charities and will be of particular interest to charities that previously used the investment services of the Official Custodian or unincorporated associations that wish to remove the need for holding trustees. It should be noted that this structure does not offer limited liability to the trustees.

Company Limited by Guarantee

A Company Limited by Guarantee is a corporate body, with a legal identity of its own, separate from its members and directors. The liability of each member is limited to a nominal sum (usually £1), which he guarantees to pay if the company has debts on winding up. As it has a separate legal entity the company holds property, enters into contracts and takes legal action in its own name. In some cases the membership is restricted but a very wide membership is possible.

The governing instrument of the company consists of the Memorandum and Articles of Association. The Memorandum states the objects and deals with other matters affecting the outside world and the Articles deal with internal rules and procedures.

The company provides a democratic structure. The members of the management committee, sometimes also called an executive committee or council of management, are the directors for the purposes of Company law and the charity trustees for the purposes of Charity law. Management of a company is delegated to a board of directors, who are responsible for the company's administration and legally authorised to act on the company's behalf. The members will usually have the right to remove the directors built into the company's constitution. Committee members may also be appointed or co-opted.

The main advantage of the company structure is the separate legal personality and the degree of limitation of liability this confers on the members and directors. It is important to realise that incorporation does not give complete protection from personal liability to the committee members, as they can in some circumstances be liable, for example under company law for breach of fiduciary and statutory duties; under the *Insolvency Act 1986* for wrongful trading, and under charity law for breach of trust.

The disadvantages are that the entity is subject to the provisions of the Companies Acts as well as charity law and this involves additional costs and red tape in compliance with statutory requirements. Under the Companies Act companies have ongoing obligations such as filing certain documents with the Companies Registry; preparing audited company accounts (unless an exemption is available); maintaining certain statutory registers etc.. The directors and officers of the company can be liable to a fine if these ongoing obligations are not complied with.

The company structure is appropriate for all larger charities engaging in substantial contracts, particularly those involved in the provision of services. It has been used for such diverse bodies as nursing homes, international aid agencies and theatre groups.

Charitable Incorporated Organisation

It should be noted the Company Limited by Guarantee was never designed with charities in mind and is primarily aimed at the "for profit" sector where the members have a common financial interest. Further, the conflict between company law and charity law can lead to confusion for both the members and directors of a Company Limited by Guarantee. Proposals have been put forward by the Government to radically reform charity law, these being aimed at simplifying the running of charities. One of the proposals is the introduction of what will be known as the Charitable Incorporated Organisation.

The Charitable Incorporated Organisation will only be available to charities and will be registered with the Charity Commission (rather than with Companies House as is currently the case with Companies Limited by Guarantee) thus avoiding the dual responsibilities of a Company Limited by Guarantee and its directors having to comply with both charity law and the Companies Acts. Existing charitable corporations will not have to convert to the new form, but if conversion is desired this will be possible by a simple conversion procedure. The proposals also supported the concept of a special corporate structure for social enterprises to be known as a "Community Interest Company". The reforms are

currently at an early stage and it is likely that it will be several years before they are made law.

What is a Guarantee Company?

A company limited by guarantee is an alternative type of incorporation used primarily for non-profit organisations that require corporate status. A guarantee company does not have a share capital, but has members who are guarantors instead of shareholders. The guarantors give an undertaking to contribute a nominal amount towards the winding up of the company in the event of a shortfall upon cessation of business. It cannot distribute its profits to its members, and is therefore eligible to apply for charitable status if necessary.

Common uses of guarantee companies include clubs, membership organisations, sports associations and charities.

For further info please visit

<http://www.ncvo-vol.org.uk/askncvo/legal/index.asp?id=107>

For information on Community Interest Companies please see separate **CIC FAQs Sheet** from Voluntary Action.

For more information about registering as a Charity please see separate **Charity Registration FAQs** Sheet from Voluntary Action