

Legal structures for new charities

December 2009

Con Alexander
Partner
E-mail: calexander@vww.co.uk
DDI: 0117 314 5214
Reference: ca



Legal structures for new charities

Background

There are a number of reasons it may be desirable to set up and register a charity with the Charity Commission. Registered charities will usually qualify for a wide range of exemptions and reliefs from Income, Capital Gains and Corporation Tax, Stamp Duty Land Tax and rates. They also qualify for a more limited range of reliefs and exemptions from VAT.

Charitable status will also usually facilitate fundraising, whether from the general public (who will generally recognise the charity "brand") or from other sources. This is partly because the obligation for registered charities to prepare and file accounts and other information with the Charity Commission will usually ensure a relatively high degree of accountability and transparency and encourage donor confidence. There is also a fairly wide range of exemptions and reliefs from tax on gifts to registered charities which encourages donations.

Legal structures

There is presently no single legal structure for charities. They can be set up in a number of different ways, although the choice is often between using a trust and using a company. This note summarises the pros and cons of each of these legal structures, which can be categorised into "unincorporated" structures (trusts and associations) and "incorporated" structures (companies, corporations, charitable incorporated organisations and industrial and provident societies). The hallmark of an incorporated charity is that it exists in its own right (with its own legal "personality").

Trusts

A charitable trust can give its trustees (who are the individuals responsible for its management and administration) wide and flexible powers to achieve its charitable objects. There are a number of advantages of using a trust to establish a charity:

- a trust's constitution will usually be fairly simple, with straightforward provisions governing the way in which trustees meet and take decisions
- a trust need only comply with the requirements of the Charity Commission and not, as in the case of a company, both the Charity Commission and the Registrar of Companies
- a trust's constitution is generally fairly straightforward to amend because this can usually be done by the trustees without the involvement of anyone else (except the Charity Commission, where its consent is required).

There are also some disadvantages of using a trust:

- because a trust is "unincorporated", it has no legal personality separate from its trustees, so that liabilities of the trust are personal liabilities of the trustee themselves; if there are insufficient trust assets to meet a third party claim, the trustees' personal assets will be at risk. This risk can often be dealt with using insurance, but this is relatively expensive and may not be effective in every situation
- the lack of legal personality also means that the trust's assets can only be held in the names of the trustees themselves and contracts with employers and others can only be made in the trustees' names. This can add to the cost and complexity of a change in trustee, when title to the trust's assets must often be transferred, and its contracts assigned, to the new and continuing trustees
- where the individual trustees are, or become, non-UK resident, the residence status of the trust may change, which may adversely affect its charitable status in certain circumstances.

Associations

Any two or more individuals can agree to establish a charitable association. A charitable association is essentially a members' club which has been established for charitable purposes and where the relationship between its members is regulated by its constitution (which forms a contract between them). The constitution will usually provide for a committee to manage the association, whose members will be its charity trustees.

An association of this kind is "unincorporated" and has all of the advantages and disadvantages of a trust outlined above.

Companies

The usual form of charitable company is limited by guarantee rather than (as is usually found in a commercial context) by shares. In practice, there are few differences and both maintain the clear distinction between the members of the company (who retain the power to alter its constitution and remove its trustees) and the trustees themselves (who are responsible for its day to day management and control and are ultimately responsible to the members). Having said that, the absence of share capital will usually mean that membership of a charitable company can be dealt with more easily and informally (which is consistent with the fact that the members of a charitable company are, unlike the shareholders in a commercial company, not entitled to any of its assets in any circumstances).

There are many charitable companies, although this may not immediately be apparent to the general public because most of them are exempt from the usual requirement to describe themselves as "limited" in their names.

The main advantages of using a company are:

- because a limited company is "incorporated", the liability of its members for its debts and other claims against it is limited, usually to a nominal sum of £1
- the trustees of a company will usually have no personal liability for claims against a company, although they can still remain liable in certain limited circumstances (for example, where the charity is insolvent and the trustees have been responsible for wrongful or fraudulent trading or have acted in breach of a warranty that they are entitled to act)
- a limited company's "two tier" structure of members and trustees is easily adapted to different governance requirements e.g. for a charity with a wide and active membership as well as a charity that will remain under the control of its trustees, who will also act as its members
- a company incorporated in England and Wales will always be resident here irrespective of the residence of its trustees.

There are some disadvantages of using a company, of which the most significant is that a company is subject to the dual regulatory regime of the Charity Commission and the Registrar of Companies. In practice, however, both regimes place very similar obligations on the trustees so that the day to day burden of dual regulation is not generally significantly heavier than in relation to a charitable trust.

Corporations

Corporations can be established by Act of Parliament or by Royal Charter. However established, a corporation has its own legal personality and, like a company, can own its own assets, enter into contracts in its own name and will confer limited liability on its members and trustees.

Royal Charters were once the only way in which a body could be incorporated. Given the availability of companies, the granting of new Charters is comparatively rare and is generally confined to eminent professional bodies or charities which have a sustained record of achievement.

A corporation is usually only established by Act of Parliament for a specific purpose.

Charitable incorporated organisations

The provisions in the Charities Act 2006 in relation to charitable incorporated organisations ("CIOs") are due to come into force in 2010. Obviously, CIOs will have charitable status once set up. The key points are:

- a CIO is broadly similar to a company limited by guarantee and will limit the liability of its trustees in a similar way. However, unlike a company, a CIO is regulated solely by the Charity Commission
- it will be possible for charitable companies and most industrial and provident societies to convert to CIO status.

We will be looking closely at how the Charity Commission are going to set up the regulatory regime before assessing whether CIOs will have advantages over existing vehicles for setting up charities. However, the fact that, unlike companies, CIOs are only regulated by the Charity Commission may offer administrative advantages.

Industrial and provident societies

Industrial and provident societies ("IPSs") are a type of incorporated body often used in the housing and care sectors. IPSs differ from companies in that they are governed by specific IPS legislation and are regulated by the Financial Services Authority, rather than Companies House.

There are two different types of IPS - co-operative societies and societies set up for the benefit of the community. The first of these exists for the benefit of its members and cannot generally be charitable, while the second is by its very nature a not-for-profit organisation that will contain provisions within its rules prohibiting distributions of profit to members in a similar manner to a charitable company.

The key points are:

- IPSs for the benefit of the community can be charitable or non-charitable
- charitable IPSs benefit from the same tax exemptions as registered charities and are subject to the same principles of charity law
- charitable IPSs are regulated by the Charity Commission as well as the FSA (except where they are also "registered social landlords").

While not as common as charitable companies limited by guarantee, IPSs have a historic not-for-profit "brand" which can be valuable from the point of view of public perception. However, they can be relatively expensive to set up and maintain from a regulatory perspective, and therefore may not be suitable for smaller charities.

Summary

A charity's requirements obviously differ from case to case but, in practice, the usual choice for those who wish to establish a new charity is between a trust and a company.

A trust is more likely to be used where:

- the charity's activities are such that the trustees' personal liability is unlikely to be an issue

- the relative administrative simplicity of a trust is not outweighed by the complexity introduced where there are many assets held by the trustees or many contracts to be entered into
- all or a majority of the trustees are, and are likely to remain, UK resident (so there is no risk to the charitable status of the trust).

A company (and perhaps in due course a CIO) is more likely to be used where:

- personal liability for the trustees may possibly be an issue; this might be because the charity will enter into contracts, have employees etc
- the charity is likely to hold a range of assets and enter into contracts
- the two tier structure of members and trustees facilitates the governance structure that is required for the charity.

In general, a trust is likely to be the best choice where a charity will act in a grant-making capacity by holding and investing a portfolio of investments out of which it will make grants to recipients.

Where, on the other hand, the charity is likely to take a more active role in advancing its objects and will need to own more complex assets, employ people, enter into contracts etc in order to do so, a company is likely to be more appropriate.

Further advice

This note provides general guidance only. You should not rely or act upon it without taking advice on your specific circumstances.

For further information please contact Con Alexander (calexander@vwv.co.uk / 0117 314 5214) or your usual contact at Veale Wasbrough Vizards.

To see our other publications visit our website at www.vwv.co.uk.