



CNT Associates – Legal Structures for Community and Voluntary Sector Organisations

When an organisation is first set up there are two key issues to consider – its **legal structure** and whether its aims and objects are **charitable**. A group with **charitable aims** has charitable status whether or not it is registered with the Charity Commission and regardless of its legal structure.

Legal structures

The usual legal structures for a voluntary/community organisation are

- An unincorporated association
- A charitable trust
- Company limited by guarantee
- An industrial and provident society.

Any group – whatever its size – needs a set of **governing rules** defining what it is set up to achieve, and a set of internal rules and procedures. The governing rules are set out in the **governing document**. The precise form depends on the legal structure adopted.

Legal structure

Governing document

[1] Unincorporated Association

Constitution

[2] Charitable Trust

Trust deed or declaration of Trust

[3]	Company limited by guarantee	Memorandum & Articles of Association
[4]	Industrial & Provident Society	Rules

Almost all voluntary organisations will be run by a committee. A management committee can be known by a number of different titles, depending on its legal structure. The most commonly used terms are:

Committee Name	Legal structure
Committee, executive committee Association Or management committee	Unincorporated
Committee or Board of Trustees	Trust
Board of Directors	Companies Limited by Guarantee
Directors	Industrial and Provident Society
Trustees	Charity (whether incorporated or not)

1. Unincorporated associations

A group is not required by law to seek approval of any kind before setting up, nor does it have to register with any regulatory body unless it is legally charitable. However, it may still have to register with some bodies once operating – for example, the Inland Revenue, the local environmental health department, social services. If your group has short-term goals and a very low income, and does not intend to employ staff or acquire property it may need only a set of basic rules under which all members will operate. These should state the group's aims, the powers it has to achieve them and its management procedures.

Advantages

Unincorporated associations are quick and cheap to set up. Unless a group is applying for charitable status no other agency need be involved in terms of legal structure. There are no fees to pay, unless you take legal advice about drawing up a constitution. They also have privacy; they do not have to answer to an external authority, for example by submitting accounts (unless the group is a charity, or accounts are required by a funding agency). Unincorporated associations also have the flexibility to design a democratic constitution. Finally, they can be wound up relatively easily at a members' general meeting, provided the constitution allows for this. Unincorporated associations can register as charities and gain all the advantages of charity status listed later in this chapter and must do so if their objects are charitable and their annual income is over £1,000.

Disadvantages

An unincorporated association has no separate legal existence, and remains for most purposes a collection of individuals. As a result, in most cases:

- It cannot acquire property in its own name; property must be held by individuals or an incorporated body acting on behalf of the group
- Legal proceedings cannot be taken by the group in its own name, but must be taken by individuals representing the group
- Individual members of the management committee can be held personally responsible for the group's obligations and debts; this is an important factor to consider when choosing a legal structure and is further discussed below

As an organisation develops, the trustees of an unincorporated association that is a charity may apply to the Charity Commissioners to become an incorporated body of trustees. If the Commissioners accept the application, this overcomes the first two disadvantages listed above as the charity property is then held in the name of the organisation and the trustees can enter into contracts or take proceedings in the name of the incorporated body. See Charity Commission leaflet CC43: *Incorporation of charity trustees* for further

details or obtain the Commission's application pack *How to apply to the Charity Commissioners for a Certificate of Incorporation* (CHY 1093)

Only incorporation, as a company or as an industrial and provident society, will provide protection for committee members against being personally responsible for the organisation's liabilities and debt. Registering an unincorporated association as a charity does not provide this kind of protection nor does incorporating the charity trustees. If you are concerned about the liability of management committee members you should seriously consider becoming a company limited by guarantee or an industrial and provident society. See *Choosing the legal structure*, page 14.

An unincorporated association may find it difficult to borrow money. Loans can be made only to individual committee members, who become personally responsible for ensuring repayments.

The constitution

Several organisations have devised model constitutions which can be adopted. Alternatively, you could adapt one being used by a similar group.

2. Charitable trusts

If an organisation does not have a need for members and wants a simple structure where a small number of people manage money or property for a charitable purpose it could consider setting up as a trust. However, only groups with charitable aims may use this structure, and it is essential to register with the Charity Commission.

Trusts are set up to manage money or property for a charitable purpose. They establish a formal relationship between three parties:

- The **donors** of money or property (the people who started off the trust by making the first donation, which may be only a few pounds), and all future donors
- The **trustees** (the Charity Commissioners usually require three), who become the normal owners of the trust property
- The **beneficiaries** (the people who will benefit from the trust).

As with all voluntary organisation, the trustees must ensure that the property or money is used for the purposes set out in the trust deed (a trust's constitution); as with all charities it is generally illegal for them to benefit personally from trust property.

Advantages

Trusts can be set up quickly and cheaply although legal advice may be needed. Apart from asking the Charitable Commissioners to approve the trust's constitution (the trust deed) and paying £5 stamp duty at the local Inland Revenue Stamp Office (listed in the phone book under "Inland Revenue"), other regulatory bodies need not be involved in the setting up process (although it may be necessary to register with some bodies once operating). Small trusts are also cheap to administer. If there is provision for changes in the trust deed, amendments can be made fairly easily; the Charity Commissioners must, however, approve any alterations to the section on aims and objectives.

Trustees can acquire and manage property on behalf of the trust, and the trust deed can give trustees powers to raise and borrow money to fulfil the aims of the organisation.

Disadvantages

Trusts must register as charities and therefore have all the restrictions facing registered charities.

Trusts are essentially non-democratic organisations. Unlike other legal structures, there is generally no membership structure – although the trust deed can be written in a way that allows for members. Trustees are generally the only people with legal powers to make decisions relating to the trust.

Trustees can apply to the Charity Commissioners to be incorporated. This enables them to hold property, enter into contracts and take court action in the name of the organisation. But even when incorporated in this way trustees can be personally liable. They are

not protected from personal liability by registering the organisation as a charity. The only way of gaining a reasonable degree of protection from personal liability for contracts is to set the organisation up as a company limited by guarantee or an industrial and provident society.

Since property is vested in the trustees as individuals, transferring it to new trustees may be complicated and expensive. It is important that the original trust deed allows for a change in trustees.

The constitution

The constitution of a charitable trust is called a **trust deed** or **declaration of trust**. There are several models that can be used, including *A model declaration of trust for a charitable trust* (GD2), available from the Charity Commission and the Charity Law Association's *Model trust deed* (DG2) – approved by the Charity Commissioners – available from Plaza Publishing (although these have different names, they are both model trust deeds).

3. Limited companies

There are two types of limited company. In a **company limited by shares** members (shareholders) invest money in the hope of gaining a profit; this type of company is generally found in the commercial sector.

The second kind is a **company limited by guarantee**. This is appropriate for organisations which aim to pursue some social or political cause. There are no shareholders and any profits are reinvested in the company. All members must guarantee to pay a nominal sum (usually £1, and almost always no more than £5) if the organisation becomes insolvent.

A limited company may also register as a charity, provided it meets the requirements of the Charity Commissioners.

Advantages

A company limited by guarantee is an incorporated organisation. This means that it has a separate legal identity as distinct from that of its members, and therefore:

- Can buy, own and sell property in its own name

- May take or defend legal proceedings in its own name
- Can protect individual members of the organisation and, in almost all circumstances, members of the management committee from personal liability.

The liability of individual members (people with a right to vote at an annual general meeting) and board members (also known as **committee members** or **directors**) is different. The extent of members' personal liability is limited to the amount they agree to guarantee. Individual members are therefore almost totally protected against personal liability in an incorporated organisation.

Under company law the board of directors is responsible for running the company.

The directors/committee members generally have no personal liability unless they:

- Act fraudulently
- Act in breach of trust, or
- Continue running the company when they know or ought to know it has no reasonable chance of avoiding insolvent liquidation.

Companies are generally democratic organisations. They are required to have a membership which usually has the power to elect, and always has the power to remove, officers and committee members. The structure works equally well for any size of group.

Because a company limited by guarantee is incorporated and therefore has a separate legal identity, owning and transferring property is relatively simple. Even when the committee or membership changes, ownership of the property remains in the name of the company, so there is no need for any documents transferring ownership.

Although most companies have to use the word "limited" as part of their name, the majority of voluntary organisations are exempt from this requirement.

It may be easier for a company to borrow money because the lender knows that the organisation, rather than a changing group of

individuals, is responsible for repayment. However, banks may still ask for personal guarantees that will make individual committee members personally liable to repay the loan if the company defaults.

Once the constitution is agreed, company registration (with the Registrar of Companies) takes two to three weeks provided there are no complications. The registration fee is low (£20 in 2000/01).

Disadvantages

Companies' activities are regulated by the Companies Acts and are usually subject to more controls and bureaucracy than other legal structures.

Annual returns and accounts must be submitted to the Registrar of Companies (for which there is a charge, £15 in 2000/01) and these are open to the public. Registers of members and directors must be kept and be available for public inspection.

Companies limited by guarantee have to notify the Registrar of Companies whenever a committee member leaves or a new one is appointed, or a committee member's personal details change. They must also notify the registrar of Companies if they enter into any legal charge (for example if they borrow money from a bank and the bank has a mortgage over the company's property).

The constitution

The constitution of a limited company consists of two parts:

- The **memorandum of association**, which contains the company's aims, the powers it has to pursue them, and the extent of members' liability
- The **articles of association**, which describe the company's rules, including its procedures for electing the board (management committee) and keeping accounts.

New Forms of Organisation – for the 21ST century

Two new forms of legal structure are currently being developed, the draft Charities Bill will provide for a new form of organisation

Charitable Incorporated Organisation (CIO) which will be an incorporated charity, i.e. have the same objectives as a charity but the protection of limited liability. The other is a community interest company, see below.

Community Interest Companies

Social enterprises (SEs) are businesses that trade with a social purpose. Consultation during 2003 showed that those in the social enterprise sector saw the need for a flexible vehicle that would allow them to engage in commercial activities, but to lock in profits for the benefit of the community. Some SEs already exist in a wide range of service areas, based on a number of different legal structures. The CIC provides an additional way of establishing an SE.

The main elements of a CIC will be:

- it takes one of three company forms
 - company limited by guarantee
 - company limited by shares
 - public limited company
- assets are locked into the company, that is, the CIC is restricted from distributing assets to its members
- it adopts a suitable constitution
- it satisfies a community interest test, confirming that it will not serve an unduly restricted group of beneficiaries
- it produces an annual community interest report