

Legal structures for voluntary and community groups

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INTRODUCTION

When people get together to carry out a particular activity, they do not immediately think about the legal nature of the group they are forming. They act together to carry out a task without realising that they may have obligations and responsibilities in law to each other.

The legal nature of a group becomes an issue when it decides to write down some form of rules for the group (usually in response to a request from a grant-making body) or in the course of seeking charitable status.

There are several legal structures to choose from. Groups should choose the structure which most suits their present needs and the needs they can envisage for the future, as the group develops. The group should also consider whether its activities are going to be charitable and if registering as a charity is necessary.

The charitable nature of a group is determined by the objects for which it is established and the activities it carries out. Once a group has considered the four options below, it may adapt a structure somewhat so that it suits the group and satisfies the Inland Revenue's requirements as a charitable group. The issues of charitable status are discussed in Advice Note 1 Charitable Status.

There are advantages and disadvantages to each structure and these should be considered carefully. In some cases one aspect of the structure is an advantage to one group, yet the same aspect may be seen as a disadvantage by another group.

(1) Associations

This is the most common form of unincorporated structure for voluntary and community organisations and is favoured by new and small groups. The association exists where a group of people band together to carry out an agreed object (other than for profit) and where it is intended that there should be some provision for continuing membership and the future existence of the group.

The association is governed usually by a constitution, the legal document which governs the association. It sets down the objects of the association, its membership and structure, and the powers it gives itself to carry out its objects. It forms a contract between the members and establishes the rights and duties they have to each other.

The association is composed of members who delegate their power to a management committee to carry out the association's activities. The management committee is elected by and accountable to the members.

Advantages of an association

- (i) **Flexibility** – the constitution of the association can be tailored to fit the varying types of association. The association is free from the statutory controls which govern the limited company.
- (ii) **Cost** – an unincorporated association is cheap to set up and run.

Disadvantages of an association

- (i) **No separate legal identity** – an association has no separate legal existence apart from the members of which it is comprised.

Within the association the members and the management group act as a group of individuals and the group has no separate legal status. This means that the association cannot enter into contracts in its own name, instead these activities are carried out by individuals within the association.

- (ii) **Property** – an association cannot own property in its own name and therefore it must make provision for individuals to be appointed as trustees to hold the assets of the association. Problems can arise where trust property continues to be vested in individuals, whether formally appointed as trustees or not, who are no longer connected with the running of the organisation and can no longer be reached or where the association has become defunct.
- (iii) **Personal Liability** – both members of the association and the management committee may incur personal liability. If, for example, a contract authorised by the management committee is entered into and the charity's funds are inadequate, the individual members of the committee would be liable to pay the debt. If an officer of the association incurs liability in the course of her/his work for the charity, has acted properly and not negligently within the terms of the constitution and the authority conferred upon her/him, s/he will be entitled to be reimbursed from the charity's funds.

The management committee of an association should ensure that the constitution is complied with, that reasonable care is taken in dealing with the charity's affairs, that commitments are only entered into if sufficient funds are available, and that competent agents and employees are employed. Proper insurance should be taken out to cover foreseeable risks.

(2) Trusts

A public trust is the traditional structure for a charity and many older charities are trusts. A charitable trust is usually governed by a trust deed which sets out the objects of the trust, names the trustees and provides for the administration of the trust. A trust is usually established by a group that does not require a membership structure for example a grant making trust or a small overseas aid organisation or a group wishing to settle property on charitable trusts. Trustees have statutory duties and powers under the Trustee Act (NI) 2001.

Advantages of a trust

- (i) **Continuity** - when the trust is established, the trustees are chosen by the founder or founder group setting up the trust. Trustees are not subject to election and usually remain in office until they retire or die, although some trusts are less rigid in their structure eg by providing for the trustees to stand down after a fixed period. When new trustees are needed, they are appointed by the existing trustees.

This could be a disadvantage where a trustee is for some reason unsuitable or has behaved improperly and is not willing to retire voluntarily. ***Trustees should ensure that there is a power to remove a trustee in the trust deed.***

- (ii) **Confidentiality** – the deliberations of trustees are usually private. Trustees are answerable for their conduct only to the Charity Commission and the courts. They need not give reasons for the way they have exercised their discretion. They need not disclose any documents or details of their deliberations.

If they act outside the terms of the trust deed, they can be taken to court in an action for breach of their trust, otherwise their decisions cannot be questioned.

- (iii) **Cost** – a trust is cheap to set up and run. There are no annual fees to be paid as there are in a company structure.
- (iv) **Control** - Trustees do not have a membership to hold them to account, they may act as they consider right without the fear of being removed because their actions are not approved by others who are involved in the work of the charity.

Disadvantages of a trust

- (i) **Inflexibility** – the objects of a trust deed can only be altered by a court order and only then in certain circumstances. If trustees considered that the objects for which the trust was set up are now outdated, they must apply to the high court for consent to alter the deed which could prove to be expensive.

However, if the trust deed is carefully drafted in the beginning, this objection can be avoided. So, make sure the deed contains the power to vary the administrative powers of the trust and that the objects clause is drafted as widely as possible. If this is the case, there should be no need to go to court to have the deed altered.

- (ii) **Personal Liability** – trustees do not have the advantage of limited liability. Trustees, like the members of any unincorporated group, are responsible for contracts entered into on behalf of the trust or actions against the trust. If these contracts are not honoured, or if the trust is sued, it will be the individual trustees who must pay the

debt or who may be sued. The trustees are entitled to be indemnified by the trust, ie they can reclaim any monies rightfully due from the trust's bank account. The problem arises when there is no money in the account.

There may be occasions when trustees find themselves personally liable for losses which they would have avoided as directors of a charitable company, eg where a claim for wrongful dismissal is made by an employee, or in an action for breach of contract, etc. Insurance will cover many potential liabilities and the funds of the trust may be sufficient to cover any debts, but where these are insufficient, the trustees are at risk. Trustees must, therefore, ensure that the activities of the trust are carefully supervised and that there is adequate control of all financial matters.

- (iii) **Transfer of assets to new appointees** – when new trustees are appointed or when old trustees retire, the property of the trust will have to be transferred into new names.
- (iv) **Lack of accountability** – as a trust is composed only of the trustees, it does not normally have members, trustees are not accountable to anyone for their decisions and are only answerable to the Charity Commission and the courts for their actions.

If the charity envisages a membership organisation which has effective democratic involvement and control over the actions of an accountable management committee, then the trust structure is not suitable and the structure of a company or an unincorporated association may be more appropriate.

(3) Company Limited by Guarantee

A company limited by guarantee is the most common type of incorporated body used by groups in the voluntary and community sector. It is constituted by its Memorandum and Articles of Association.

Advantages of a company limited by guarantee

- (i) **Flexibility** – there is power in the Companies Act 2006 to alter both the objects of a company and the regulations which govern administrative matters. However, a charitable company will contain a provision that no alteration will be made which would cause it to cease to be a charity at law.
- (ii) **Corporate identity** – the company is a legal person capable of owning property, or taking or defending actions in court. As it can own property in its own name, there is no need to appoint holding trustees to hold the property of the charity.
- (iii) **Limited liability** – the company is a legal person and its debts and contracts belong to the company itself and not to its members. A member or officer of a company is not personally liable if the company is sued or owes money. Her/his liability in the event of the company being unable to meet its debts and going bankrupt, is limited to the amount that s/he guarantees when becoming a member. This amount is usually £1.00.

Members and officers of the company are protected by this limited liability of the company in respect of contracts they make on behalf of the company.

This limited liability is important where the charity is considering borrowing large sums of money, buying land or buildings, or employing staff who might create liabilities for the charity by acting outside the practical control of the person responsible for overseeing staff.

However, the protection from liability is not absolute. If an officer or director acts negligently, or not in the best interests of the company, or while disqualified, etc, they may not be able to avoid personal liability. It is worth noting as well that limited liability does not always provide protection, as banks and lending institutions may require a personal guarantee from directors before they are willing to lend money. Businesses or suppliers entering into contracts with the company may also insist on the individual directors entering into any transaction as individuals and not as company directors.

- (iv) **Involvement of members** – the company is a democratic structure where members have ultimate control over those managing the company. Directors are answerable to the members for the conduct of the company's affairs and are capable of being removed from office by a resolution of the company. New members can join the company and can also be expelled from the company.
- (v) **Continuity** – until it is wound up, a company has perpetual succession, ie it continues to exist, even though its members may change, die or cease to be involved in the activities of the company. While winding up the company is a complex business, it is preferable that this is undertaken, when the purpose for which the group originally formed is no longer applicable.

Disadvantages of a company limited by guarantee

- (i) **Cost** - the cost of setting up a company is higher than the cost of setting up an unincorporated body. For example, a fee is usually charged for drafting the memorandum and articles of association - the 'governing document' of a company.

There is a registration fee when registering the company at Companies House and producing the accounts in company format may also cost more.

There are ongoing costs of money and time in administration of the company once the company is up and running. For example, there is an annual fee for making annual returns to Companies House (ie details of the company's directors, secretary and official address). Dissolving a company also involves time and expense.

- (ii) **Public Accountability** - Companies' details are stored on the index of company names (the index) which is open to the public. For a small fee anyone can look up details about an individual company. This may not be seen as a disadvantage to many as it assists those voluntary organisations which believe in openness and accountability to the general public.
- (iii) **Bureaucracy** – companies must comply with the statutory requirements of the Companies Act 2006 which sets out detailed rules for the administration of a company. The need to comply with company law could be a burdensome responsibility on members of a voluntary management committee.

Most voluntary organisations incorporate when they secure funding and are able to pay workers with the time and know-how to ensure that company administration is dealt with efficiently.

The limited liability offered by the company structure may not be required by charities which seldom get involved in quasi-commercial activity where limited liability is important. Where groups are considering taking on employees or borrowing large sums of money, then the advantages of the company structure may outweigh the disadvantages. In most other cases those responsible for the activities of the charity may protect themselves against most hazards by insurance.

If your group decides that it wants to incorporate as a company limited by guarantee then please read NICVA's Advice Note 6: Setting up a Company for further guidance.

(4) Industrial and Provident Society

An IPS is a society carrying on an industry, business or trade for the benefit of the community. It must also be either a co-operative society or a business conducted or intended to be conducted for the benefit of the community. An IPS tends to be a bona fide co-operative society which is democratically run and which ploughs profits back into the society. A minimum of seven members is required to set up an IPS. An IPS is set up by the adoption of model rules or rules drawn up by the group itself.

Advantages of an Industrial and Provident Society

- (i) **Incorporation** – an IPS is an incorporated group with the same advantages of the company structure mentioned above, ie corporate identity, limited liability, continuity and involvement of members.
- (ii) **Arbitration** – the Registrar of Friendly Societies may arbitrate when disputes arise.

Disadvantages of an Industrial and Provident Society

- (i) **Cost** – the rules of the IPS are submitted to the Registrar of Friendly Societies who will register the IPS on payment of a fee. The fee is £200 if model rules are used, or £535 if the group draws up its own rules. It takes longer to register the IPS with the Registry than it takes to register a limited company.
- (ii) **Lack of privacy** – in common with the company structure, the IPS is subject to public scrutiny as annual returns are made to the Registrar.
- (iii) **Charitable status** – as an IPS is defined as a “society carrying on an industry, business or trade”, it is unlikely to be compatible with the requirements of Charity Law, which prohibit a charity from trading. In addition, a bona fide co-operative is run for the benefit of its members. This is directly opposed to the charitable principle that charities must benefit the public. However, some Industrial and Provident Societies, notably housing associations, are deemed to be charitable.
- (iv) **Inflexible** – the rules of the IPS are not as flexible as the rules of the limited company.

(5) Community Interest Company

The Community Interest Company (CIC) was introduced in 2007 as a new corporate structure for non-charitable social economy enterprises that want to use their profits and assets for the public good. The CIC may be a company limited by guarantee, a private company limited by shares or a public limited company limited by shares and is subject to company legislation.

It will have to register with Companies House with memorandum and articles of association and a community interest statement to confirm that the company will provide benefit to the community. It does this by describing its proposed activities, who the company will help and how. CICs are regulated by the UK wide CIC Regulator which can provide information and advice on setting up and running a CIC.

One of key characteristics of a CIC is that it has an asset lock which ensures that the company retains its assets for the benefit of the community, as stated in the community interest statement.

The same advantages and disadvantages apply to a CIC as are listed above for the company. As the CIC is not a charitable organisation, it doesn't have the same restrictions on paying directors. Directors of a CIC can be paid therefore this type of structure is attractive to social entrepreneurs who want to establish an organisation which benefits the community but also want to derive payment for their work.

The CIC regulator has produced some very detailed guidance and information on the CIC which can be downloaded from its website.

(6) Charitable Incorporated Organisation

The Charitable Incorporated Organisation (CIO) is a new legal structure specifically for charities. The CIO is similar in some ways to a limited company offering protection of trustees from personal liability without the need for dual registration with company and charity law. The CIO will be regulated by the Charity Commission for Northern Ireland.

Secondary legislation is required to make it a viable option for charities and it is envisaged that it will not be available before 2011. In the meantime, charities may incorporate as a company limited by guarantee and then convert to a CIO when it is available.

FOR FURTHER INFORMATION, PLEASE CONTACT:

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Website: www.nicva.org

NICVA's governance and charity advice staff can assist with drafting a suitable governing document for your organisation as well as offering specialised training on governance issues.

All of NICVA's advice notes, as well as the most up to date information about the implementation of company and charity law, can be downloaded from www.nicva.org.

www.diycommitteeguide.org

Online governance resources mapped to the principles of the Code of Good Governance.

Companies House Belfast

1st Floor, Waterfront Plaza
8 Laganbank Road
Belfast BT1 3LR

Tel: 0845 604 8888
Website: www.companieshouse.gov.uk

Companies House produces a range of guidance notes and online forms

The CIC Regulator

CIC Team
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Tel: 029 20346228. This is a 24-hour voicemail service.
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Website: www.cicregulator.gov.uk/

Registry of Credit Unions and Industrial and Provident Societies

1st Floor, Waterfront Plaza
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