

# qLegal

The small print for BIG IDEAS

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## qLegal Online Publication

### DOING SOCIAL GOOD & CHOOSING YOUR CHARITY STRUCTURE

Are you running a cultural, educational or sports not-for-profit program? If so – have you considered implementing a charity structure which would allow your program to benefit from its philanthropic purpose?

When setting-up a charity, ensure that:

- 1) the charity has an exclusively *charitable purpose*; and
- 2) you have decided on the most appropriate legal structure.

#### **1) Ensuring the charity has an exclusively charitable purpose**

To be recognized as a charity by law, an organization must be established exclusively for one or more charitable purposes, i.e. each purpose must be a “*charitable purpose*”, a charity cannot carry out any “non-charitable purpose”. There are 13 “*charitable purposes*” as defined by the Charity Act 2011 (the “**ChA 2011**”), which must be carried out for the benefit of the public. Whilst there is no statutory definition for “the benefit of the public” requirement (so it can evolve over time and respond to social and economic change), the UK Government has issued some guidance on the public benefit requirement.<sup>1</sup>

The following non-exhaustive list of purposes qualify as charitable: the prevention or relief of poverty, the advancement of education, religion, health or the saving of lives, citizenship or community development, arts, cultures, heritage or science, amateur sport, human rights, environmental protection or improvement. However, a political purpose is not considered as a charitable purpose.

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<sup>1</sup> <https://www.gov.uk/government/publications/public-benefit-the-public-benefit-requirement-pb1/public-benefit-the-public-benefit-requirement>.

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Attention should be paid when drafting a charity's objects to ensure they fall within the *charitable purpose* guidance set out in ChA 2011. Further, ensure the drafting is clear and precise and leaves sufficient scope to cover every activity the charity may carry out during its lifetime<sup>2</sup>.

### **2) Deciding on the charity's legal structure**

Issues to consider when deciding on the charity's legal structure:

- a) Do the activities carried out involve any level of risk or complexity beyond awarding grants for charitable purposes, i.e. does the charity use or own land, provide goods and services, enter into significant contractual liabilities such as loans and employment contracts?
- b) Are the members, i.e. people who set the charity, going to be involved in the work of the charity and play a role in the governance?
- c) Is the set-up of the charity simple and what are the administration costs?

The most common legal structures used to set up a new charity are: (i) charitable incorporated organization (the "CIO"), (ii) charitable company limited by guarantee, (iii) unincorporated association, (iv) charitable trust and (v) community interest company ("CIC").

#### **(i) Charitable Incorporated Organization (CIO)**

CIOs are a new type of legal structure available for a charity that wishes to be incorporated. "Incorporated" refers to a registration with the Charity Commission and not the Registrar of Companies (Companies House). A CIO only comes into existence when registered with the Charities Commission.

A CIO is a legal entity regulated by charity law that can enter into contracts in its own right. Its trustees generally will not have any liability for the debts of the CIO. For larger charities, particularly grant-making charities or those that have large permanent endowments, it might be difficult to justify becoming a CIO, especially if the charity is already registered with Companies House.

#### **(ii) Charitable Company Limited by Guarantee**

The 'charitable company' is a type of charitable organisation under which charities can now be set up and to which existing charitable associations or trusts can convert. In either case, a Charitable Company limited by guarantee is to be registered both at Companies House (as a company) and with the Charity Commission as a charity in its own right. It is imperative to note that, a charitable company, as an incorporated body, can purchase and own property, will be liable for its own debts, and can transact business with third parties. As it's also a limited company, the charitable

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<sup>2</sup> The ease to change a charity's objects depends particularly on their constitutional structures and how far from their existing objects they intend to move.

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company will have directors and members; and the directors will act as trustees in accordance with the Charities Act. The most significant advantage of such form of a Charitable Organisation is that the founders of such a Charitable Company are fully protected because of the limited liability status of the Charitable Company. Charitable companies must comply with both charity and company law.

### **(iii) Unincorporated Association**

An unincorporated association is not a distinct legal entity to the members related to it. It is the legal form usually implemented by members' clubs, sports clubs and societies. In practice, this can cause complications for third parties dealing with such associations. However, the flexible process for setting up and governing an unincorporated association may seem attractive. For example, it operates on the basis of its own guidelines/rules that determine the rights and duties between the members and how power is administered in the association. Such rules can be agreed orally or in writing and there are no rules on the procedure or content for such rules. The key principles for an unincorporated association are that it should:

- Involve two or more individuals with a mutual non-business commitment.
- Have contractual interactions between those persons.
- Be administered by rules.
- Be non-temporary.

### **(iv) Charitable trust**

A trust is a contractual relationship created by a trustor, in lifetime or on death, when assets are placed under the control of one or more trustees for the benefit of a beneficiary or for a specified purpose. A charitable trust is created when the purposes for which the trustees must hold the trust property are recognized as exclusively charitable. To set up a charitable trust, trustees, who may be either individuals or a corporate body, must be appointed. They hold the legal title of the charitable trust's properties and are responsible for managing and administering the charity's affairs. In addition, a trust deed or declaration is required to set up and govern the trust.

Once a trust that fulfils the criteria for charitable status is created, its trustees have a duty to apply to the Charity Commission to register it as a charity unless (i) it has a gross annual income of £5,000 or less in any financial year or (ii) it is exempt or excepted from registration<sup>3</sup>.

A charitable trust is a type of unincorporated charity, meaning it is not a legal entity in its own right and has no separate legal personality. As a result, the charity trustees:

- have joint and several personal liability for the debts and liabilities of the charity;
- enter into contracts and own assets in their own names; and

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<sup>3</sup> <https://www.gov.uk/government/publications/exempt-charities-cc23/exempt-charities>;  
<https://www.gov.uk/government/publications/excepted-charities/excepted-charities-2>

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- may be sued in their own names on matters regarding the charity.

Consequently, if a charity's proposed activities involve an enhanced degree of risk or complexity, a charitable trust may not be recommended.

However, it is a possibility for the trustees to apply to the Charity Commission for a certificate of incorporation of the trustees as a body corporate, therefore allowing the vesting of the charity's property in the name of the corporate body and enabling the charity's trustees to enter into contracts and sue and be sued in the name of the corporate body rather than in their own names. Nevertheless, this does not provide limited liability protection for the trustees, meaning that the trustees will remain answerable and accountable for their own acts, neglects and defaults and for the due administration of the charity and its property as if the incorporation had not been affected. The procedure is purely for administrative convenience.

In practice, a charitable trust is suitable when a donor or a member of a single family wishes to manage their charitable giving by settling money or other property for general or specific charitable purposes or when the charity's primary or sole activity is making grants.

### **(v) Community Interest Company**

A CIC is a limited liability company, intended for social organizations that want to use their profits and assets for communal interest. A CIC has the explicit goal of offering assistance to the public and must use its revenue, monies and proceeds for the public. The primary purpose of a CIC is to help the public and not its shareholders, directors or personnel. CICs can either be incorporated as a new company or else converted from a current company. They can be companies limited by shares or by guarantee nevertheless they must fulfil and continue to fulfil a community interest test. A company must pass a community interest test to become a CIC. A community interest test must provide such evidence of community interest by providing a community interest statement and must also demonstrate that a rational being would believe that its doings are being carried on for the benefit of the community.

It is important to note that a CIC is not a charitable structure but instead a hybrid for-profit/public good business that exists for for-profit companies that want to show consumers and investors that they care about more than just profits. CICs are similar to charities however there are numerous significant differences. The following are a few key characteristics of CICs: they benefit the community, they are a limited liability company, they have to pass a community interest test, they cannot transfer their assets for less than the market value and assets are used exclusively for the benefit of the community (known as 'asset lock'), and they are regulated and supervised by a regulator. Particularly, CICs are not subject to the burdensome rules of registering and controlling a charity. CICs are able to have a much more commercial nature and can also benefit from some of the advantages of limited companies for example having limited liability and having the capability of issuing shares and paying dividends. The CIC must be incorporated like a legal entity, with all its formalities such as capital and initial shareholding,

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appointment of directors amongst others and the Memorandum and Articles of Association of the company must clearly distinguish that the company is a CIC<sup>4</sup>.

### SUMMARY CHART

Structure	Advantages	Disadvantages
CIC	<b>Setup and operation</b>	
	<ul style="list-style-type: none"> <li>▪ It only needs to be registered with Charity Commission.</li> <li>▪ Flexibility, for example, CIC constitution can allow for decisions at meetings to be by consensus.</li> <li>▪ Regime for electronic communications with members is also less rigid than the regime that applies to charitable companies i.e. you can email all members without receiving permission first.</li> </ul>	<ul style="list-style-type: none"> <li>▪ It does not come into existence until registered with the Charity Commission – therefore you cannot open a bank account etc. in its name until it is fully registered</li> <li>▪ It is not as straightforward as running an unincorporated association or a charitable trust.</li> <li>▪ Members of a CIC will not have rights to receive accounts, call meetings, vote by proxy, demand a poll and remove a trustee unless the constitution expressly provides them.</li> </ul>
	<b>Liability</b>	
	<ul style="list-style-type: none"> <li>▪ It has limited liability for trustees and members.</li> </ul>	
	<b>Funding</b>	
		<ul style="list-style-type: none"> <li>▪ CIC legislation makes no provision for the maintenance of a register of charges - may make it more difficult to borrow.</li> </ul>
<b>Other</b>		
<ul style="list-style-type: none"> <li>▪ Charities can transfer the ownership of any trading subsidiary company to the CIC.</li> </ul>	<ul style="list-style-type: none"> <li>▪ May not be suitable for large/complex charities.</li> </ul>	

<sup>4</sup> <https://www.gov.uk/government/publications/community-interest-companies-constitutions>.

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<b>Charitable company limited by guarantee</b>	<b>Setup and operation</b>	
	<ul style="list-style-type: none"> <li>It has quicker registration process than for a CIO.</li> <li>The members have more rights than for a CIO (e.g. calling meetings, voting by proxy, removing trustees).</li> <li>The trustees cannot be paid for their role and cannot normally be employees.</li> </ul>	<ul style="list-style-type: none"> <li>A company form adapted for charities with two regulators (Charity Commission and Companies House) – trustees therefore have dual roles: charity trustees and company directors.</li> </ul>
	<b>Liability</b>	
	<ul style="list-style-type: none"> <li>It has limited liability.</li> </ul>	
	<b>Funding</b>	
	<ul style="list-style-type: none"> <li>It has access to funds from trusts, foundations etc.</li> </ul>	
<b>Other</b>		
<ul style="list-style-type: none"> <li>It has charitable tax reliefs.</li> <li>The members of the public may be more likely to trust a registered charity.</li> </ul>	<ul style="list-style-type: none"> <li>There are limits to areas of trading that fall outside the charitable objects (up to £50,000)</li> </ul>	
<b>Unincorporated association</b>	<b>Setup and operation</b>	
	<ul style="list-style-type: none"> <li>Simple and low cost set up.</li> <li>Running of the company is quite informal; do not need to file any accounts or information with the Companies House.</li> <li>Lower compliance costs.</li> </ul>	<ul style="list-style-type: none"> <li>Does not have separate legal existence from its members.</li> <li>Land and investments can only be held in the name of the officers or trustees.</li> <li>The association cannot enter into formal contracts.</li> </ul>
	<b>Liability</b>	
		<ul style="list-style-type: none"> <li>Not a limited liability company and thus the members can be held personally responsible.</li> </ul>
<b>Funding</b>		
<ul style="list-style-type: none"> <li>Multiple ways of raising funds: subscription fees, association can borrow and can receive funding from central or local government or grants</li> </ul>	<ul style="list-style-type: none"> <li>The Unincorporated Association cannot sue a person for not paying its first subscription fee as it means it hasn't as yet become a member.</li> </ul>	

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	from organisations, through levies or by receiving gifts.	<ul style="list-style-type: none"> <li>Borrowing has to be explicit in the association's rules, otherwise they cannot do so.</li> <li>Organisations that help with the funding expect a degree of control over the association.</li> </ul>
	<b>Other</b>	
		<ul style="list-style-type: none"> <li>No liquidation procedures exist.</li> </ul>
<b>Charitable trust</b>	<b>Setup and operation</b>	
	<ul style="list-style-type: none"> <li>Flexible structure.</li> <li>Quick set-up as little formality is required.</li> <li>The administration is relatively simple as subject to less rigorous regulation.</li> <li>No charge fee.</li> </ul>	<ul style="list-style-type: none"> <li>No separate legal personality.</li> <li>Common Reporting Standard regime may apply as well as a registration to the HMRC's Trust Registration Service.</li> </ul>
	<b>Liability</b>	
		<ul style="list-style-type: none"> <li>Individuals enter into contract in their personal capacity, i.e. they are personally and severally liable for debts and other liabilities of the trust (unless a certificate is provided by the Commission)</li> </ul>
	<b>Funding</b>	
		<ul style="list-style-type: none"> <li>The charitable trust is unlikely to enter into significant contractual liabilities such as mortgage and funding arrangements.</li> </ul>
<b>CIC</b>	<b>Setup and operation</b>	
	<ul style="list-style-type: none"> <li>Simple to operate since it is like a normal company.</li> <li>Flexibility of structure: it can be set up as a private company limited by shares, private company limited by guarantee or public limited company.</li> <li>Quicker to form than a charitable company.</li> <li>Lower level of on-going governance for a community interest company than a charity.</li> </ul>	<ul style="list-style-type: none"> <li>Formalities of incorporation</li> <li>Ongoing compliance</li> <li>Ongoing reporting</li> </ul>
	<b>Liability</b>	

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	<ul style="list-style-type: none"> <li>It is a limited liability company so offers protection to its directors.</li> </ul>	
	<b>Funding</b>	
	<ul style="list-style-type: none"> <li>Access to certain forms of finance as funds are used for a specific purpose so donors are more willing to invest.</li> </ul>	<ul style="list-style-type: none"> <li>Certain grants and funding schemes that are open to charities aren't available for CICs.</li> </ul>
	<b>Others</b>	
<ul style="list-style-type: none"> <li>CIC status confers a clear commitment to common cause</li> </ul>	<ul style="list-style-type: none"> <li>In contrast to charities, CICs cannot claim tax reliefs</li> <li>Restrictions on dividends as only CICs limited by shares may declare dividends</li> <li>Asset lock</li> <li>Onerous to convert a CIC to another structure.</li> </ul>	

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