

## 1. Getting started

### 1.5 Choosing legal structures

#### Legal status

Your legal status is the way your organisation is defined in law, based on the way it is set up and the rules and regulations that govern it. All organisations have some kind of legal status whether they're aware of it or not, if there is an underlying intention to create a legal relationship (even if they do not have a written governing document).

There are two main types of legal structure:

**Unincorporated** - e.g. Associations, Trusts

**Incorporated** - e.g. Companies limited by guarantee, Industrial & Provident Societies, Community Interest Companies, Limited Liability Partnerships, (Charitable Incorporated Organisations once introduced under the Charities Act 2006).

#### **Incorporated – Unincorporated What's the difference?**

An incorporated organisation has a legal identity of its own. In other words, it's a corporate body that can legally act as a single entity. This means that it can own property, enter into contracts and employ people in its own name.

An unincorporated organisation, on the other hand, remains a collection of individuals, and if it wants to own property and so forth, it must rely on individuals to do so on its behalf.

Incorporation also means the liability of the organisation to third parties is limited to the total amount of the member's guarantees or share capital, depending on the nature of the organisation. This affords protection to those running the organisation and its members in most cases.

#### **So what's best for your organisation?**

There are pros and cons to both types of legal structure. Factors that you need to consider include: the size of your organisation, setting up and running costs, the level of risk involved, and democratic decision-making processes.

Typically organisations will opt for incorporation where they are undertaking inherently risky activities such as buying premises, employing staff, raising large scale finance, entering into large contracts, etc.

It's important to get your legal structure right, because the wrong structure can get in the way of doing your work effectively and may increase the risk of personal liability. It can be a good idea to seek professional legal advice, or advice from your County Voluntary Council (CVC) at the outset.

## **Charitable status**

The legal status of your organisation is quite separate from its charitable status. Charities can be either incorporated or unincorporated. If your organisation has charitable objects and meets the minimum criteria it has to register with the Charity Commission.

If an organisation is charitable, no matter what its legal structure, members of the governing body are known as *Trustees*. You can think of charitable status as something laid on top of your existing legal structure.

See Information Sheet 1.6 Charitable status for further information.

## **Social enterprises**

A social enterprise is a business whose objectives are primarily social, and whose profits are reinvested back into its services or the community. Social enterprises come in many shapes and sizes, from small community-owned village shops to large organisations delivering public services.

It is what a business does with its profits that determines whether it is a social enterprise, rather than its specific legal structure. A social enterprise is NOT a type of legal structure, it is a type of business which can take on a variety of legal forms including all of the ones listed below (although there are some restrictions with Industrial and Provident Societies). The legal structure chosen for each specific social enterprise will determine what governing document it has in place, as is the case with any voluntary group.

## **Here are some of the things you need to consider before you decide what's right for you.**

For most voluntary organisations the choice is usually between being an unincorporated association or a company limited by guarantee.

## **Unincorporated structure - Unincorporated association**

### **Some typical features of an Unincorporated association:**

- It's a group of people who have decided to work together to pursue a common agreed non-commercial purpose - e.g. a club, society, local group, community association. There must be an intention to create a legal relationship but this does not have to be set out in writing.
- Unincorporated businesses involving two or more persons with the object or earning profit for them or others, is a partnership rather than an association.
- It is not regulated by an external regulator or subject to specific legislation, although some case law does exist. If it is charitable it will be subject to general charity law and regulated by the Charity Commission if it is a registered charity.
- It's a common structure for voluntary groups, especially small scale organisations.
- It's relatively easy and cheap to set up and run. It faces few regulations, so there's less bureaucracy.
- It's free to make up its own rules (as long as these rules don't break the law).
- It's not legally required to have a written governing document, but it's good practice to have one and a prerequisite if it's a registered charity.
- Because it is unincorporated, it does not have a separate legal personality so ownership of an association's assets lies with individuals acting on its behalf, usually governing body members. This means that each time one of these individuals leaves, the assets must be legally transferred to another. The same goes for any legal agreements the association has entered into in this way.
- Its governing body members will be personally liable for any of the association's debts which can't be met out of its own resources. This could be of concern if the organisation starts to run up large bills or enter in potentially risky activities such as taking on a lease.

## **Unincorporated structure - Trust**

### **Some typical features of a Trust**

- It arises where assets (e.g. property, investments etc.) is given by one person (the Settlor or Donor) to another (the Trustee) with the intention that it should be applied for the benefit of a third party or the public (the Beneficiary). Once this occurs, the trustees own the asset but can only apply it in accordance with the trust for the benefit of the beneficiaries.
- It's not regulated by an external regulator (unless it is a charity) but is subject to various legislation, most notably the Trustee Act 2000.
- It's usually created by a document known as a Deed which has certain formalities.
- It's an unincorporated body and those running it, the trustees, have personal liability for its debts and obligations.
- It's a useful structure where you want to retain control amongst a small body of people with no external membership.

- It faces the usual problems of unincorporated structures relating to asset ownership and transfer.
- Confusion can arise with terminology. Those running it are known as Trustees whether it is charitable or private. However, those running other types of organisations (e.g. directors of companies) will only be known as trustees if their organisation is a charity (a charity is a form of trust).

## **Incorporated structure – Industrial and Provident Society**

### **Some typical features of an Industrial and Provident Society**

- It takes 2 forms: co-operative societies for the mutual benefit of members (e.g. producers' and consumers' co-ops), and non-profit making organisations carrying out an industry, business or trade for the benefit of the community.
- It has corporate status, and can have a share and loan capital, but must pay only moderate interest on any loan capital.
- It is less well understood than other corporate structures and specialist advice should be sought from the Financial Services Authority if you are thinking of adopting this form of legal structure.
- Industrial and Provident Societies for the benefit of the community with exclusively charitable objects cannot register with the Charity Commission as they are classed as Exempt charities. They can apply to the Inland Revenue Charities Division to be classed as charitable for tax benefits though.
- It is regulated by the Financial Services Authority and subject to the Industrial and Provident societies Act 1965 and other legislation.

## **Incorporated structure – Company limited by guarantee**

### **Some typical features of a Company limited by guarantee:**

- It's a membership organisation formed and registered under the provisions of the Companies Acts.
- It's incorporated and enjoys limited liability.
- It's a private limited company that has guarantors rather than shareholders, so it's suitable for voluntary organisations. The members agree to pay a fixed amount known as a Guarantee, in the event the company winds up or can't pay its debts (usually between £1 to £10).
- It's a structure usually chosen by voluntary organisations that employ staff, regularly enter into contracts, manage investments, and/or own property and other assets, etc because limited liability helps to minimise the threat of personal liability for the directors.
- It's more heavily regulated than an association, so it's usually more expensive and complicated to set up and run.
- Its governing body is made up of the Directors who have legal responsibility for the company and ensure it carries out its activities properly.

- It's able to hold contracts and assets in its own name as it has a separate legal identity to those who run it.
- It doesn't matter if the directors change because it is the company and not the directors that holds title to land, enter into contracts, etc. but changes must be notified to Companies House.
- Its directors will not be personally liable for the company's debts, provided they don't act negligently or improperly.
- It is regulated by Companies House and subject to the Companies Acts and other legislation.

## **Incorporated structure - Community Interest Companies (CIC)**

### **Some typical features of a Community Interest Company:**

- It's a new type of company designed for social enterprises which can be limited by shares or guarantee. It is formed in the same way as an ordinary company with additional restrictions, including the need to meet an ongoing community interest test.
- It's subject to an 'asset lock' which ensures that profits are retained for community purposes, but it can raise finance via borrowing and the issue of shares within statutory limits.
- It cannot register as a charity but a charity can convert to a CIC with Charity Commission approval.
- It's regulated by the Regulator of CIC's at Companies House and subject to the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Companies Acts.

## **Incorporated structure - Charitable Incorporated Organisation (CIO)**

The CIO is a proposed new incorporated legal structure created exclusively for registered charities, which is due to become into force from Spring 2012. A CIO will enjoy all of the benefits of incorporation as it is a charitable company. In addition, it will only be regulated by the Charity Commission thus doing away with the traditional burden of dual regulation for ordinary charitable companies. Existing organisations will be able to convert .

## **CASC status (Community Amateur Sports Club)**

The Community Amateur Sports Club Scheme (CASC) was introduced in April 2002. This has enabled many local amateur sports clubs to register with the HM Revenue & Customs (HMRC) and benefit from a range of tax reliefs, including Gift Aid.

Sports clubs must be formally constituted so that the conditions of the scheme become binding on the members and their governing committees. This means that clubs wishing to apply for CASC status will need to look carefully at their governing document to make sure it fits in with the CASC requirements before they apply to

HMRC (see below for more on governing documents). In principle, sports clubs can have any legal structure and still be able to take on CASC status, but in practice the main structures adopted are unincorporated associations, Industrial and Provident Societies (IPS') and companies limited by guarantee. Whatever legal structure is chosen though, the governing document for that structure must be formally adopted by the members to be acceptable.

The conditions for becoming a CASC are fairly easy to meet but the sports club must fit in with these in practice, as well as having these as requirements in the club rules. The club must:

- be open to the whole community
- be organised on an amateur basis
- have as its main purpose providing facilities for, and promoting participation in one or more eligible sports
- meet the location requirement
- meet the management condition.

A registered CASC cannot be recognised as a charity for tax purposes. However, it is open to any sports club which is not a registered CASC to apply to the Charity Commission or other charity regulator to be registered as a charity as an alternative. Clubs proposing to seek charitable status should not apply for CASC status.

## **Changing your legal status**

You can change your organisational status, but seek advice from your County Voluntary Council before you do. The most common change is to become incorporated.

## **Why change?**

- Because your organisation has grown and employs staff.
- Because your organisation has acquired property and/or other major assets.
- Because your organisation is undertaking activities that increase the risk of liability to third parties (e.g. entering into large-scale contracts).
- Because your organisation's financial turnover has substantially increased.

However, incorporation of an existing organisation does not merely involve registering with Companies House and changing your name.

In fact, a new corporate organisation of your choosing has to be registered and assets, staff etc transferred over before dissolving your existing organisation. **This is a complex process and professional legal advice should be sought.**

## What is the Governing Document?

It's a kind of *instruction manual* for your organisation.

Your governing document sets out your legal status, what your organisation aims to do, how it will do those things, and how it should be run.

What the document is called depends on the legal status of your organisation. It could be:

*A Constitution* - if you are an association

*A Trust Deed* - if you are a trust

*The Memorandum & Articles of Association* - if you are a company limited by a guarantee or CIC

*The Rules* - if you are an industrial and provident society.

## Why do you need a governing document?

**So that everyone knows what you're there to do** - Organisations exist to meet needs in society. Your governing document spells out your *Objects* - the needs your organisation was set up to meet - and how you will deliver them. It also sets out the powers available to the governing body to achieve these objects.

**So that your governing body can meet and take decisions** - Most voluntary organisations have a governing body that is legally responsible for the organisation's activities. Your governing document sets out the governing body's obligations and administrative rules for running it.

**So that you can define your membership and their rights and responsibilities** – many voluntary organisations have a membership which allows them to involve their stakeholders in various aspects of the organisation. Your governing document sets out the terms of membership and other administrative provisions that allow them to participate in your organisation.

**So that you know what can be done with the organisation's assets** – usually your governing document will restrict use of the organisation's assets to achieving the objects, but sometimes it will also allow payment from them to governing body members in exceptional circumstances (e.g. payment for professional services). It also specifies what is to be done with the assets should the organisation wind up, usually transfer them to a not for profit organisation with similar objects.

**Think about the future as well as the present:**

**Most organisations grow or change over time and it's important that your governing document lets you do this** - so when you're designing it, think about what

you might want to do in the future, as well as what you intend to do now. It's easier to build flexibility into your governing document at the start, rather than to change it later on. Ensure you have a specific power to amend the governing document.

### **We've drawn up our governing document, what now? - don't put it in a drawer and forget about it:**

- Governing body members must follow the governing document, so make sure they all receive a copy of it.
- Then make sure they've all read and understood it.
- Remember, your governing document is like an instruction manual, so everyone involved should refer to it regularly to remind themselves what the organisation was set up to do and how it should run.
- And regularly review it to ensure it is sufficient for your current and future projected purposes. If it isn't, amend it.
- Don't be the kind of organisation that only looks at its governing document when it hits a spot of bother. You may find that you could have avoided the problem altogether if you'd all been more familiar with it in the first place.

### **What should your governing document contain?**

#### **Clauses that say what your organisation is set up to do:**

- What you aim to do – *the Objects*.
- Who will benefit – *the Beneficiaries*.
- The geographical area you will cover – the Area of benefit.
- What you are allowed to do in order to pursue your aims and objectives – the Powers.

#### **Clauses that say how your organisation will be run:**

- Who can be a member of the organisation (if appropriate) and how they become or cease to be members.
- Rules for holding and running general meetings that are open to all the members of the organisation (as opposed to governing body meetings).
- Rules for appointing or removing governing body members, and rules for running their meetings.
- Rules for managing money and property, including the power to borrow and invest.
- How to amend the governing document and any restrictions on what can be amended.
- How governing body members can be reimbursed for legitimate expenses, paid for services provided to the organisation or otherwise remunerated.
- How to make secondary rules, sometimes known as bye-laws, to run in conjunction with the governing document and help in the administration of the organisation.
- How to wind up the organisation and what to do with its remaining assets.

## Further advice

Charity Commission for England & Wales

Tel: 0845 3000 218

[www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)

Companies House

Tel: 0303 1234 500

[www.companies-house.gov.uk](http://www.companies-house.gov.uk)

HM Revenue and Customs

[www.hmrc.gov.uk](http://www.hmrc.gov.uk)

Regulator of CICs

Tel: 029 20346228

[www.cicreg.gov.uk](http://www.cicreg.gov.uk)

Financial Services Authority

Tel: 020 7066 1000

[www.fsa.gov.uk](http://www.fsa.gov.uk)

CASC Info

[www.cascinfo.co.uk](http://www.cascinfo.co.uk)

## Disclaimer

The information provided in this sheet is intended for guidance only. It is not a substitute for professional advice and we cannot accept any responsibility for loss occasioned as a result of any person acting or refraining from acting upon it.

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