

LEGAL STATUS PROS AND CONS

WHY BOTHER ABOUT LEGAL STATUS?

Anyone can get together and agree to start a group without legal formalities. In law, this is called “an unincorporated association” i.e. it is not a corporate body or company. There are other kinds of legal structures which you may wish to choose. The following list gives the advantages and disadvantages of the main types. Please note you can be A and B or B and C! You are then subject to both sets of requirements; however there is a new structure which will make this simpler.



The Chesterfield and North East Derbyshire Council for Voluntary Service and Action Limited
Reg Office: Ground Floor, Blenheim Court,
17 Newbold Road, Chesterfield, S41 7PG,
Tel/Fax 01246 274844
E-mail: linkscvs@btconnect.com
www.linkscvs.org.uk

A. UNINCORPORATED ASSOCIATION

The advantages of this kind of group are:

- ◆ flexible, quick and cheap to set up
- ◆ can have any aims and rules – easy to change these from time to time
- ◆ members can have a say in day-to-day decisions
- ◆ paid staff can be on the committee
- ◆ no limits on political activity
- ◆ no limits on trading
- ◆ no rules re format of accounts or where they have to be submitted
- ◆ easy to wind up

The disadvantage of this kind of group are:

- ◆ the groups is not a legal identity
- ◆ property cannot be held in the group’s name
- ◆ there is no limit to the financial liability of individual members
- ◆ no automatic relief from Corporation Tax
- ◆ no automatic relief from business rates
- ◆ may not impress funders or donors
- ◆ individual members of the committee are jointly and severally liable for contracts
- ◆ people may be unclear about liabilities

B. CHARITIES

A Charity is a ‘body or trust which is for a charitable purpose that provides benefit to the public’.
Charitable Purposes – there are 12 specific headings and one general heading.

- the prevention or relief of poverty;
- the advancement of education;
- the advancement of religion;
- the advancement of health or the saving of lives;
- the advancement of citizenship or community development;
- the advancement of the arts, culture, heritage or science;
- the advancement of amateur sport;
- the advancement of human rights, conflict resolution or reconciliation, or the promotion of religious or racial harmony or equality and diversity; the advancement of environmental protection or improvement;
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- the advancement of animal welfare;
- the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or the ambulance services; and
- other purposes that are currently recognised as charitable or are in the spirit of any purposes currently recognised as charitable.

The advantages of this kind of group are:

- ◆ automatic relief of 80% business rates
- ◆ usually automatic relief from Corporation Tax
- ◆ more respectable in the eyes of the public
- ◆ may be easier to raise money from many different types of funders and donors
- ◆ some charitable trusts will only fund charities
- ◆ easier to attract committee members
- ◆ support from Charities Commission

The disadvantages of this kind of group are:

- ◆ objects and activities must be exclusively charitable
- ◆ must register with the Charity Commission if turnover above £5,000
- ◆ paid staff cannot be on the committee
- ◆ committee members (trustees) cannot be paid
- ◆ constitution must follow charity rules
- ◆ accounts must be in a prescribed format & submitted to the Charity Commission
- ◆ limits on political activity & campaigning
- ◆ limits on who can be a trustee

C. INCORPORATION (LIMITED COMPANY)

The advantages of this kind of group are:

- ◆ the organisation is a legal entity
- ◆ can enter into contracts, rent or own property in own right, no need for holding trustees
- ◆ limited liability for members & governing body
- ◆ paid staff can be on the committee*
- ◆ no limits on political activity*
- ◆ no limits on trading*
- ◆ transparency – details of directors public
- ◆ written models of Memorandum of Agreement and Articles of Association
- ◆ company status is respected by public and funders
- ◆ Company Secretary can be a member of staff or a Board member
- ◆ Company accounts format provides structure
- ◆ permanent succession – no need to transfer contracts or leases when someone leaves who signed originally
- ◆ permanent – company exists until dissolved even if dormant

The disadvantages of this kind of group are:

- ◆ false sense of security e.g. limited liability disappears if technically insolvent
- ◆ company directors are still personally liable if negligent
- ◆ in practice, most landlords require named individuals to be liable for leases
- ◆ most lenders would require named sureties
- ◆ details of directors and members public
- ◆ language of “Memo and Arts” not user friendly
- ◆ restrictions on who can be a company director
- ◆ need a Company Secretary
- ◆ administration requirements heavy
- ◆ company law requirements: registered number and where registered must be on publicity, must hold an AGM, submit annual accounts, company returns and resolutions
- ◆ risk of fines and imprisonment if company requirements not followed – over 200 criminal offences within company law
- ◆ formal process needed to bring it to an end –
- ◆ cannot just pass a resolution to dissolve.

* not if also a charity

D. CHARITABLE COMPANY

This has the advantages and disadvantages of B and C combined with the added complication of having to follow two different sets of rules, charity law and company law.; two registration processes with two different bodies – the Charity Commission and Companies House – two returns to be submitted each year.

E. CHARITABLE TRUSTS

These are usually set up **to raise and/or distribute funds**. There will be a trustee board with no beneficiary involvement. They are regulated by the Charity Commission and are **unincorporated bodies**. This makes administration and governance less complicated. However, this also means individual members can be held liable for debts. They lack the structure and assurance for large scale activities or funding.

F. TRUSTEE INCORPORATION

This is not frequently used. It enables the governing body of a charitable trust or charitable association to incorporate itself. This gives the trustee body a legal entity and enables them to enter into contracts, own property and take action as a corporate body without giving the trustees limited liability.

G. INDUSTRIAL AND PROVIDENT SOCIETIES (IPS)

This structure is suited to *bona fide* (genuine) **co-operatives** and to **voluntary organisations trading** or carrying on an industry or business for the benefit of the community. Members agree to purchase one or more shares in the IPS and their liability is limited to the amount unpaid on the purchase of the shares. It is unlawful for an IPS to say it is a registered charity even if was set up for charitable purposes: it can say it is "a charity exempt from registration" and/or use its Inland Revenue charity reference numbers. ALL IPSs register with Mutual Societies Registration, part of the Financial Services Authority. The Registry of Friendly Societies has a supervisory responsibility for IPSs. From April 1st 2004 the very strict rules voiding all acts outside the IPS's or committee powers were eased. From the same date, where the name of a charitable IPS does not include the word "charity" or "charitable", the fact that it is charitable must be stated on business letters, notices, advertisement, cheques, orders, invoices, receipts etc. From 20th October 2003 IPSs no longer need to have a seal.

From 6th April 2006 non-charitable community benefit industrial and provident societies can pass a special resolution to amend their rules, "locking in" assets so they cannot be distributed to members, but must always be used for the benefit of the community. This does not apply to charitable community benefit IPSs, which are already subject to an asset lock under charity law, and registered social landlords.

Co-operatives are democratically run by the members with each member having one vote at general meetings. It is quite common for workers to be members (workers co-ops). Some co-ops allow profits to be distributed to members; others are set up on a not-for-profit basis where the profit is put back into the business.

The advantages of this type of group are:

- ◆ worker and community member control
- ◆ the advantages of incorporation: limited liability, legal personality, permanent succession, right to own property
- ◆ less legislative requirements
- ◆ less public disclosure
- ◆ less risk of fines and prosecution than in company law
- ◆ don't need to send accounts to each member therefore costs are lower
- ◆ model rules available

The disadvantages of this type of group are:

- ◆ conflict of interest between workers needs and those of the co-op
- ◆ high structural complexity and difficult to get advice on procedures from voluntary sector advisers or lawyers
- ◆ IPS not a structure familiar to funders
- ◆ must have three members
- ◆ must be democratic - no places for outside bodies on governing body
- ◆ slow, cumbersome registration process & more expensive than for companies
- ◆ co-ops have variable history of success

H. COMMUNITY INTEREST COMPANIES

Community Interest Companies are specially designed for social enterprises and the not-for-profit sector. They register with Companies House as a company limited by guarantee or a company limited by shares, then apply for CIC status to the new Regulator of Community Interest Companies. The regulator will need to be satisfied that the organisation meets "a community interest test" and will genuinely operate for the benefit of the public.

Community Interest Company must be included in the title, limited cannot be used in its name. CICs must produce an annual community interest company report with information relevant to CIC. The constitution must contain an asset-lock clause, which ensures that its assets can never be distributed to private individuals or companies. Community Interest Companies can pay their directors salaries providing they are not trustees. The Community Interest Companies Regulator imposes strict rules and organisations will be monitored on a regular basis.

A charitable company based in England or Wales can convert to a CIC, but only if the Charity commission agrees that it is in the charity's interest. Social Enterprises may use this as the most appropriate legal structure.

The advantages of this kind of group are:

- ◆ freedom to trade
- ◆ able to pay Directors
- ◆ retains benefit within the community
- ◆ can bring in investment
- ◆ tax benefits for investors
- ◆ not having to comply with company & charity law

The disadvantages of this kind of group are:

- ◆ no tax benefits - rates etc.
- ◆ some Charitable Trusts cannot fund
- ◆ auditing the Community Interest statement
- ◆ additional costs
- ◆ will not necessarily attract investors

I. DEVELOPMENT TRUSTS, VILLAGE DEVELOPMENT COMPANIES, CIVIC TRUSTS, COMMUNITY REGENERATION COMPANIES

These will take one of the forms under A-H. The Development Trusts Association says, "The legal structure of development trusts is most frequently that of a company limited by guarantee....As the activities of development trusts are frequently charitable, many development trusts apply for charitable status, so that they are operating through a charitable company....However, since development trusts also aim to earn income through trading activities – and there may be limited on what they can do as a charity – they frequently set up subsidiary trading companies which can covenant profits back to the main charitable company".

J. PARTNERSHIPS

Some partnerships are loose informal structures without any specific legal status. Others may have working rules, protocols, or even "constitutions". Those with very detailed rules may be classified as unincorporated associations. Partnerships concerned with regeneration or strategic partnership often use a separate limited company or local authority as an accountable body through which funds may pass.

K. OTHER FORMS OF LEGAL STATUS

There are many specialised forms of legal status, some of which are subject to legislative regulation e.g. housing associations and credit unions. Organisations such as the Chamber of Commerce, trades unions and employers federations are part of the “wider voluntary sector”. Talk to Links if you are not sure about any thing.

SOCIAL ENTERPRISES

Social enterprises (sometimes called community enterprises, or community businesses) are a concept not a legal structure. Any of the structures listed above (unincorporated association, limited company, trading arm of charity, registered charity, IPS, credit union, co-operative or Community Interest Company) can operate a social enterprise. Franchised social enterprises are being developed which replicate successful models, sometimes as satellite projects of the main organisation.

“Social firms” are businesses which provide employment for disabled people.

The “social economy” is a term which encompasses social enterprises, social firms and the whole range of charities, voluntary and community groups.

LATEST PROPOSED CHANGES TO CHARITY LAW

THE CHARITABLE INCORPORATED ORGANISATION (CIO)

This is the first legal structure created exclusively to meet the needs of charities. It has the benefits of incorporation, but organisations need only register with the Charity Commission and not Companies House as well.

There have been several delays with implementing this structure. It is anticipated that it will come into force in April 2010.

There will be advantages of CIOs over charitable companies.

- Single registration
- Less onerous requirements when preparing accounts.
- Less onerous reporting requirements
- Only one annual return
- Less onerous filing requirements
- Less onerous requirements relating to the reporting of constitutional and governance changes
- Lower costs
- Simpler & more constitutional forms
- More straightforward merger arrangements

This new legal structure will:-

- ◆ Modernise charity law and status to provide greater clarity and a stronger emphasis on the delivery of public benefit;
- ◆ improve the range of legal forms enabling organisations to be more effective and entrepreneurial;
- ◆ develop greater accountability and transparency to build public trust and confidence; and
- ◆ ensure independent, fair and proportion regulation.

Clearer focus on public benefit

At present public benefit is only assessed on application for charitable status. The report proposes that every charity will be expected to publish in their annual report an explanation of how they provide public benefit and the Charity Commission will systematically check these. In addition, the Charity Commission will be undertake checks on the “public character” of charities which charge high fees e.g. public schools and private hospitals.