

MEMBER SERVICES

Advice Note 3: Legal Structures

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. Four of the most commonly used structures are discussed in this document. Each structure can be used by a group carrying out charitable activities and this leaflet is designed for such charitable voluntary groups.

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 not discussed in this leaflet.

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. The four alternatives described below should be studied with the present and future needs of your group in mind.

(1) UNINCORPORATED BODIES (TRUSTS AND ASSOCIATIONS)

1.1 Trusts

This is the traditional structure for a charity and many older charities are trusts. A trust is 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 an individual or a group wishing to settle their own property or specific property on charitable trusts.

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Every effort is made to ensure that the contents of this document are accurate, but the advice given should not be relied on as a definitive legal statement.

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 can be a disadvantage where a trustee is for some reason unsuitable or has behaved improperly and is not willing to retire voluntarily. If there is no power to remove a trustee in the trust deed, an application may have to be made to court to remove her or him. It is unlikely, however, that the court will take any action unless the trustee's actions have caused the administration of the trust to deteriorate to such an extent as to damage the interests of the charity.

On the other hand, as trustees are independent of the membership of the charity, 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.

The self-perpetuating nature of a trust ensures a continuity which may be considered attractive to funding bodies. It also attempts to ensure that people acceptable to the original founder/s will be appointed as trustees in the future. This continuity may help to reduce disputes about how the trust should be run in the future.

- (ii) Confidentiality – the deliberations of trustees are usually private. Trustees are answerable for their conduct only to 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.

Again, this point may be considered a disadvantage by groups which want openness and accountability to play an important part in their choice of structure.

- (iii) Cost – there is no charge to set up and run a trust. NICVA Member Services can assist with drafting a trust deed, but the group will need to have it approved by a solicitor before the group uses it. A trust need not be expensive to run. There are no annual fees to be paid as there are in a company structure and there is no requirement that accounts be audited.
- (iv) Certainty – the nature and scope of a trustee's duties are well established in law, so if problems are encountered, there are well established guidelines for the trustees to consult and follow.

Disadvantages of a trust

- (i) Inflexibility – 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 court for consent to alter the deed.

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.

So, 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. This may involve trouble and expense, particularly where the old trustees have lost touch with the activities of the group and can no longer be reached.
- (iv) Restriction on the trustees' powers of delegation – it is a general principle of trust law that a trustee cannot delegate the performance of her/his duties to others. A majority of trustees in a charitable trust can make decisions and would usually delegate the day to day administration of the charity to a committee of trustees, especially where there is a large number of trustees or where meetings are held infrequently.

If the group is considering delegating decisions to outsiders, the structure of a trust may be unsuitable.

- (v) Lack of control by members – a trust is composed of the trustees. It does not have members. Trustees are not accountable to anyone for their decisions and are only answerable to 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 group, then the trust structure is not suitable and the structure of a company or an unincorporated association may be more appropriate.

1.2 Associations

This is the most common form of structure for voluntary organisations. 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 by a set of rules or a constitution which sets down the objects of the association, its membership and structure, and the powers it gives itself to carry out its objects. The association is composed of members who delegate their power to a management group to carry out the association's activities. The management group is accountable to and elected by 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. NICVA Member Services can help voluntary groups with getting appropriate constitutions.

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. The constitution is the legal document which governs the association. It forms a contract between the members and establishes the rights and duties they have to each other. 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 own property or enter into contracts, etc. These activities are carried out by individuals within the association.
- (ii) Trustees – as the association cannot own property, provision must be made for individuals to be appointed as trustees to hold the assets of the association. Frequently, the association does not formally appoint trustees, and property (eg land or equipment) is bought in the name of

officers or committee members. These individuals may be acting as trustees without any clear definition of the trusts on which they hold the property. 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 charity 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.

It is extremely important that those concerned with an unincorporated association and, in particular, the management committee, 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) INCORPORATED BODIES (COMPANIES AND INDUSTRIAL AND PROVIDENT SOCIETIES)

2.1 Company Limited by Guarantee

A company is constituted by its Memorandum and Articles of Association which are normally drawn up by a solicitor. A company limited by guarantee is the usual form of limited company found in the voluntary sector. A minimum of two members is required to set up a company.

Advantages of a company limited by guarantee

- (i) Flexibility – there is power in the Companies (NI) Order 1986 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 to its Memorandum of Association 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, 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 without undue formality.
- (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 - it costs money to set up and run a company. The Memorandum and Articles of Association are usually drafted by the group's solicitor and there is a registration fee. Annual accounts and an annual return must be submitted to the Companies Registry and there is an annual fee.

- (ii) Lack of privacy – there is a statutory requirement to inform the Companies Registry of any changes in directors. Company documents are available for public inspection.
- (iii) Bureaucracy – companies must comply with the statutory requirements of the Companies Orders. These set out detailed rules governing change of objects, rights of members, meetings, etc. The group may consider it to be worthwhile employing someone who is familiar with these requirements as the Company Secretary to ensure that these formalities are complied with, for example, the law requires that the name of a company must appear on **all** its literature.

Companies must have the following information on all business letters and order forms:

- The company's place of registration and its company registration number.
- The address of its registered office.
- Where a company has permission to omit the word 'limited' from its title, the fact that it is a limited company must be stated on letter headings and order forms.

Companies which are also charities and which do not have the word 'charity' or 'charitable' in their title, must state the fact that they are charitable on all business letters, notices, official publications, bills of exchange, promissory notes, endorsements, cheques, orders, conveyances, invoices, receipts and letters of credit.

The limited liability offered by the company structure may not be required by charities which after all 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.

2.2 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. The rules of the IPS are not as flexible as the rules of the limited company.

- (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 over £100 if model rules are used, or several hundred pounds 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.

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