

# LEGAL STRUCTURES

## Factsheet 5

This factsheet covers

- Why legal structures matter, and what they are.
- The difference between incorporated and unincorporated organisations and the pros and cons of incorporation
- A short summary of the different legal forms available for both incorporated and unincorporated organisations
- The advantages and disadvantages of charitable status, and some of the issues groups should consider if they are thinking of applying for charitable status

It should be read in conjunction with our 'choose a structure' flowchart, to help you decide on the most appropriate legal form for your organisation.



### Why legal structures matter

Having the right legal structure is key to helping you run your organisation as effectively as possible, and provides the most appropriate mechanism for you to deliver services.

### What is a legal structure?

A legal structure combines an organisation's

- Legal form – That is, what sort of body it is in the eyes of the law
- Governing document – That is, the document that sets out how it plans to operate and govern itself

### What is a legal form?

A legal form is the sort of organisation it is considered to be in the eyes of the law, for example, whether it is a company limited by guarantee, or a society, or an association. It's important that members of any organisation are clear about how the law may affect them, and the organisation itself, and so they need to understand the implications of the legal form the organisation adopts.

Legal form is not the same as organisational type or status. The type of organisation you are may determine what activity you undertake, or the organisations relationship with any members, or how it operates or what sector it operates in (eg, a social enterprise, or a supporters' trust), but it would not be recognised in the eyes of the law. Any group of people may come together informally to achieve some common outcomes (provided their aims and activities are legal) and they generally they don't need to be regulated (unless they are undertaking some specific work like financial services) – they can just get on with what they want to do.

You may decide, however, that your structure needs to be more formal, and this will affect your choice of legal form. The main decision at this stage is whether to incorporate or not.

## What is a governing document?

The governing document is a written statement that sets out the purpose of the organisation, its structure and describes how the organisation will operate. The term 'governing document' is a general term. Depending on the chosen legal form, this document might be called one of a number of different names, for example, constitution, partnership agreement, articles or even (for societies) 'the rules'.

The governing document should contain information about all the practical matters related to how an organisation is run, including

- Its aims or objects and how they will be achieved.
- Who the members are, how and why they can become members and how they meet and make decisions.
- Whether there is a governing body, what is it called, how it is appointed and how it meets and makes decisions.
- What happens to any profit/surplus.
- What happens to assets when the organisation is sold, taken over or broken up

Model governing documents are available a range of incorporated and unincorporated bodies; please see our separate fact sheet on this.

## Incorporated and unincorporated organisations

When thinking about which legal form might be best, members need to decide if being incorporated is most appropriate for them, or whether to remain unincorporated. The difference is that being incorporated creates a legal identity (a corporate body) that is distinct from its members, whereas in an unincorporated organisation, as far as the law is concerned, the organisation remains a collection of its members.

## Advantages of incorporation

Members of an unincorporated organisation have unlimited, personal liability and usually that liability is what is called 'joint and several'. This means that as the group does not exist as a separate unit, it is legally simply as a group of people and therefore they are seen as being jointly responsible for the body and its activities, but can also be held responsible individually. This means that if the organisation has, for example, any debts which it can't pay, legally members can be held liable for them, and may have to pay them. As liability is limited to the extent of each member's personal assets, the impact may be greatest for those who are most able to pay. In the first instance claims would be made against members of the governing body.

In contrast, all members of a corporate body (ie an incorporated organisation) are protected by limited liability. When they agree to become a member of the corporate body they commit themselves to paying a fixed amount if the organisation is wound up with outstanding debts. There are times when members of the governing body of a corporate body can be held personally liable for some, or all, of the debts of their organisation, for example, where one or more members of the governing body have acted fraudulently or irresponsibly.

It is important to note that when an existing unincorporated organisation is insolvent, incorporating will not protect the members from previous liabilities.

## Owning property and entering into contracts

As an unincorporated organisation does not technically exist in law, it cannot own property or enter into contracts. All property will be owned by one or more of the members of the organisation and one or more members will be personally responsible for any contracts the organisation may hold (generally this is the person who actually signed the contract). In some circumstances, the whole governing body may become legally liable (and that liability is, as before, unlimited).

Clearly it is important for people who enter into contracts on behalf of an unincorporated organisation to make sure that they have authority to do so. It is best practice to make sure that your organisation's governing document protects the members as they will not be protected in law. Not being able to own property, or sign contracts, as an organisation (collectively) can cause problems if someone who has signed contracts dies, or wishes to leave the organisation.

## Disadvantages of incorporation

There are extra costs involved with being a corporate body rather than an unincorporated organisation. Some organisations will need to pay to be registered, and there may be recurring annual fees and ongoing administration costs.

## Administration/reporting

There are strict rules about the records that a corporate body must keep and those that must be presented to the the organisation they are registered with and regulated by. These are important, and organisations can be penalised if they don't keep their records and reporting up to date. However, the requirements for an incorporated organisation are generally proportionate and not overly problematic.

# Privacy

In return, as it were, for limited liability, there is a requirement to provide certain information to the regulatory or registration body, including details of the name, address and date of birth of members of your governing body, and information about your finances and so on. This information is available to the public.

## Summary of the pros and cons of incorporation

	UNINCORPORATED	INCORPORATED
Liability	Individuals may have to meet any outstanding debts personally.	Individual liability is limited to a guarantee amount or unpaid share capital
Ownership	It is not possible to enter into contracts in an organisation's name and there are difficulties with members' authority to do so.	A corporate body may own property and enter into contracts in its own right
Risk	Risk can be unequally distributed among members.	Risk is more equal. All members are treated the same unless there is some other agreement in place.
Cost	There are generally no or limited start-up costs but may be subject to ongoing running costs	There will be start-up costs plus annual fees (although a relatively small amount).
Administration	None needed by law (unless a charity)	Ongoing records need to be kept and filed with the appropriate registry.
Privacy	Complete (unless a charity)	Certain details, such as governing body members' names are on public record

SOURCE: [www.uk.coop/resources/simply-legal](http://www.uk.coop/resources/simply-legal)

## Should you incorporate?

There are several factors that you need to think about when deciding this. Which factors are most important will be different for each organisation, but the key thing to consider is the level of risk this organisation has across factors such as if you currently (or plan to) employ staff, enter into contracts, or if you have a significant turnover – if the answer to those questions is yes, your risk may be greater than if you just have a small team of volunteers and a low turnover, and so you may feel that incorporation is advisable.

If you decide that incorporation isn't right for you, it is good practice to review that decision, and go through another risk assessment, both regularly and when your circumstances change.

# Summary of different legal forms for both incorporated and unincorporated organisations

## Main forms of unincorporated organisations

- a) Associations: this is the most common form of unincorporated organisation. The details of an association's objects and how it will be run should be set out in a governing document (normally called a constitution).
- b) Trusts: a Trust exists where one or more individuals (or a single corporate trustee) administer funds or resources which have been donated by donors for the benefit of another group (beneficiaries). It's an unincorporated organisation and its governing document is a Trust Deed. They should not be confused with companies and societies who do not operate in this way, but who have the word Trust in their name (such as Development Trusts).
- c) Friendly societies – it is no longer possible to register a new Friendly Society (other than an insurance society)
- d) Partnerships: a partnership is a contractual arrangement between two or more people. They are normally set up with the aim of making and sharing profits between the partners, and are therefore not considered suitable for voluntary or charitable organisations.

## Main forms of incorporated bodies

- a) Limited company
  - a. Public limited company: it is unlikely that voluntary organisations would want to use this form, but if you do, please seek expert and legal advice
  - b. Private company limited by shares: can issue shares, but not to the public. Some social enterprises choose this form
  - c. Private company limited by guarantee: each member guarantees a certain amount (often £1) in the event of the company being wound up with outstanding debts.Companies are administered by Companies House. Their governing document is called The Articles.
- b) Community Interest Company (CIC): this form is designed for organisations who wish to use enterprise and delivery social objectives, but which don't want/need charitable status, or which are not eligible. CICs have a compulsory asset lock, and to register as a CIC a community interest test must be passed. CICs are registered with Companies House, but it is the CIC Regulator who determines whether they pass the community interest test. CICs can be a private company limited by shares, a private company limited by guarantee, or a public limited company (see caveat at 3.4.1 a))
- c) Charitable Incorporated Organisation (CIO): Until recently, most charities that wanted corporate status registered as companies limited by guarantee. They are therefore regulated by the Charity Commission and Companies House. The CIO form provides the benefits of incorporation but only needs to register with, and report to, the Charity Commission. There are two structures - single tier (which has a governing body with no wider membership) or two tier (a governing body with a separate membership base). The Charity Commission provide model governing documents (Constitutions) for both forms.

d) Limited Liability Partnerships (LLPs): are generally not suitable for many third sector organisations as they are required to undertake profit making activities, but they can be an alternative to a private company for, eg, workers co-operatives.

e) Society: can take two forms: a co-operative society and a community benefit society (BenCom) which have slightly different characteristics (a co-op benefits its members, a BenCom must have wider community benefit). Regulated by the Financial Conduct Authority. It is possible for a BenCom to apply for exempt charity status. The governing documents of a Society are called 'The Rules'. Model rules are available from a variety of sponsoring bodies.

### Summary of the key features of the different legal forms

Legal form	Does its members have limited liability?	What is its governing document called?	Can it issue shares?	Can it pay a return on shareholdings?	Does it have to register with a regulatory body?	Is it suitable for charitable status?	Does it have an asset lock?
Partnerships	No	Deed	No	No	No	No	No
Associations	No	Constitution	No	No	No (unless a charity)	Yes	No (unless a charity)
Trusts	No	Deed	No	No	No (unless a charity)	Yes	No (unless a charity)
Limited Liability Partnership (LLP)	Yes	Agreement or Deed	No	No	Companies House	No	No
Company Limited by Guarantee	Yes	Articles	No	No	Companies House	Yes	No (unless a charity)
Company Limited by Shares	Yes	Articles	Yes	Yes	Companies House	No*	No (unless a charity)
Community Interest Company (limited by guarantee)	Yes	Articles	No	No	Companies House & CIC Regulator	No	Yes
Community Interest Company (limited by shares)	Yes	Articles	Yes	Yes – although it is subject to a cap	Companies House & CIC Regulator	No	Yes
Charitable Incorporated Organisation	Yes	Constitution	No	No	Charity Commission	Yes	Yes
Industrial & Provident Society (bona fide co-operative)	Yes	Rules	Yes	Yes	Financial Services Authority	No	No
Industrial & Provident Society (society for the benefit of the community)	Yes	Rules	Yes	Yes	Financial Services Authority	Yes	Yes (optional)

SOURCE: [www.uk.coop/resources/simply-legal](http://www.uk.coop/resources/simply-legal)

It is important to note that a legal form is not the same as an organizational type. Different types of organisation, for example, a Community Land Trust, or a Community Amateur Sports Club, or a Tenants or Residents Association can take an appropriate legal form.

## Charitable status

Neither is 'a charity' a legal form. A charity is an organisation that exists to benefit the public by having certain purposes that are legally recognised as charitable. Being a charity is a status, which is in addition to its legal form and its organizational type. An organisation cannot just be a charity, it has to have an appropriate legal form (and appropriate governing document) to apply for charitable status. Charities are registered with the Charity Commission for England and Wales. The Charity Commission is a regulatory body and can take action against charities where trustees have failed to comply with legal requirements.

## Registration

Unless you are an exempt or excepted charity, if your organisation meets the statutory definition of a charity, and has an income of £5,000+ a year, you must register with the Charity Commission. Generally, the Charity Commission won't let an organisation with a smaller income register, although it may make an exception if an organisation can show that, for example, a significant grant is dependent on registration. A CIO does not have to meet the minimum income threshold, as it does not legally exist until it is registered with the Charity Commission. Organisations who register with the Charity Commission, including CIOs, must make sure that their governing documents comply with charity law requirements

## What is charitable under the Charities Act 2011

To be recognised as charitable, an organisation must demonstrate that it operates for the benefit of the public, and that its activities fit within one or more of the Act's defined charitable purposes. Further details of these can be found in Appendix I

## Being a charity: Advantages...

4.3.1 Tax: Charities are not exempt from paying tax, but they benefit from several exemptions and reductions, such as exemption from income tax, capital gains tax and corporation tax on profits (when used to further the charity's purposes; 80% mandatory (and potentially 20% discretionary rate relief on buildings used for charitable purposes); stamp duty; potential exemptions or zero rated VAT on certain goods and services; and other tax reliefs relating to social investment

4.3.2 Funding: there are increased options, as many funders will only grant funds to charities

4.3.3 Public image: in general, the public has a strong belief in the work carried out by charities, and this may help with donations, legacies and other fundraising

4.3.4 Regulator: the Charity Commission does have the power to check on charities, but alongside this it (and also HMRC's charity team) offer support and advice on a range of relevant issues

## And disadvantages

4.4.1 Limitations on payments to members of the governing body. In general, being a trustee is a voluntary position, and trustees should not financially benefit from their position. There are a few permitted exceptions, including payment of expenses, and, with conditions, for services or goods that are above and beyond the role of trustee (if this is allowed by your governing document)

4.4.2 Limits on trading activity: charities may engage in certain types of trading, both primary purpose, and ancillary (not for primary purpose) trading, although there are limits on how much of the latter they can undertake, and how profits are used. It is possible for a charity to set up a wholly (or partially) owned trading subsidiary for larger ancillary trade.

4.4.3 Campaigning: charities are limited in the amount and type of campaigning work they can carry out, and if you think any of your campaign activity will be outside these limits you should seek advice, and consider the guidance on this produced by the Electoral Commission.

4.4.4 Members benefits: an organisation is not charitable if it exists mainly to benefit its own members. It is fine if members benefit as an incidental by-product of a charities activities and where there is greater public benefit. A charity can be run by and for the benefit of its beneficiaries, providing the charities activities benefit others people as well as members of the charity.

## Appendix I: Public Benefit Test and Charitable Purposes

### The public benefit requirement

Your charity's 'purpose' is what it is set up to achieve. For an organisation to be a charity, each of its purposes must be for the public benefit. The Charities Act 2011 calls this the 'public benefit requirement'.

The public benefit requirement has two aspects:

The 'benefit aspect'

To satisfy this aspect:

- a purpose must be beneficial - this must be in a way that is identifiable and capable of being proved by evidence where necessary and which is not based on personal views
- any detriment or harm that results from the purpose (to people, property or the environment) must not outweigh the benefit - this is also based on evidence and not on personal views

The 'public aspect'

To satisfy this aspect the purpose must:

- benefit the public in general, or a sufficient section of the public - what is a 'sufficient section of the public' varies from purpose to purpose
- not give rise to more than incidental personal benefit - personal benefit is 'incidental' where (having regard both to its nature and to its amount) it is a necessary result or by-product of carrying out the purpose

In general, for a purpose to be a charitable purpose it must satisfy both the benefit and the public aspects. However, charities for the relief (and in some cases the prevention) of poverty need only satisfy the benefit aspect.



## Charitable Purposes

- a) the prevention or relief of poverty
- b) the advancement of education
- c) the advancement of religion
- d) the advancement of health or the saving of lives
- e) the advancement of citizenship or community development
- f) the advancement of the arts, culture, heritage or science
- g) the advancement of amateur sport
- h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
- i) the advancement of environmental protection or improvement
- j) the relief of those in need, by reason of youth, age, ill-health, disability, financial hardship or other disadvantage
- k) the advancement of animal welfare
- l) the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services
- m) any other purposes currently recognised as charitable or which can be recognised as charitable by analogy to, or within the spirit of, purposes falling within (a) to (l) or any other purpose recognised as charitable under the law of England and Wales

For more details on the types of activities which may fall within each purpose, please see the [Charity Commission Guidance CC4: What Makes a Charity](#).

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Voluntary Impact Northamptonshire provides basic free advice on certain aspects of Governance. However, for more in-depth support consider our Executive Membership or our costed Consultancy Service. Simply contact [info@voluntaryimpact.org.uk](mailto:info@voluntaryimpact.org.uk) in the first instance.

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