



Legal update — May 2017

Charities Structural integrity



One of the most important decisions that those setting up a charity will make is which legal structure they should adopt. Broadly, the choice is between an unincorporated association, a trust, a company limited by guarantee (CLG), a charitable incorporated organisation (CIO), and a community benefit society (CBS). There are advantages and disadvantages to each, and those setting up the charity will of course want to try to choose the most appropriate legal structure for their situation.

Choosing a structure at the outset does though involve making some predictions or assumptions as to how a charity will operate. It may be that, in practice, factors such as the availability of funding or property or the rate of growth of the charity mean that a charity evolves and moves in an unanticipated direction. It may also be that changes in the law mean that new advantages or disadvantages apply to particular structures.

Therefore, in certain situations, trustees of a charity may want to change their structure at a later date. Here we look at three structural changes that trustees might make – one that has been quite common, one that has not really taken off, and one that we predict we will see more of in the future.

Incorporation of an unincorporated charity
The most common type of restructure we see in the charity sector is the incorporation of a previously unincorporated charity. Unincorporated associations and trusts are examples of unincorporated charities. Historically, particularly before the company structure was introduced, most charities were established as trusts. Although fewer are established today, for reasons discussed further in this article, there are still a large number of charitable trusts in existence.

The distinguishing feature of an unincorporated charity is that it has no legal personality, meaning that it does not have the capacity to enter into contracts, hold assets in its own name, or sue or be sued. An unincorporated association’s trustees must enter into contracts or hold assets in their own name. This therefore creates a potential risk to the trustees’

personal assets if they cannot adequately cover a liability out of charity funds.

Corporate structures such as a CLG, CIO, or CBS do have legal personality and so can hold assets and enter into contracts as an entity. The trustees of corporate structures will generally not therefore be personally liable for their charity’s liabilities.

For this reason, we rarely now advise that an unincorporated charity would be the most appropriate structure. Those charities that have been set up as trusts historically may have grown and taken on large numbers of staff, properties, and contracts, and with them more risk. We also therefore now regularly advise a number of trusts to incorporate their charity, to protect their trustees from personal liability. This is the most common type of restructure we see and we will continue to see going forward.



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Conversion of a CLG into a CIO
Another potential restructure a charity can undertake is to convert from a CLG to a CIO.

More recently, because of the issue of personal liability, the CLG had become the most popular legal structure for charities, and it has been a very useful and successful one. However, the CLG does have some potential disadvantages because it was not a structure specifically designed for charities.

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For this reason, the CIO was introduced in the Charities Act 2006 and then made available for charities in 2013 as an alternative structure. The CIO is modelled on the company, so shares a lot of the same characteristics and advantages, but it is a dedicated charity structure.

The main disadvantage of the CLG, which the CIO sought to address, is the issue of 'dual regulation'. Since a CLG is both a registered company and a charity, it is subject to both company and charity law and has to report to two regulators, Companies House and the Charity Commission. The CIO is only subject to charity law and only has to report to the Charity Commission.

There is a process by which existing CLGs can convert to CIOs. While more and more new charities are choosing to establish themselves as CIOs, and this will undoubtedly become the most popular structure going forward, few CLGs have actually chosen to convert to CIOs. In practice, many CLGs consider that dual regulation is not a significant disadvantage and that the cost and effort of converting outweighs the potential advantage of single regulation. We therefore expect that we will continue to see relatively few CLGs converting into a CIO.

Conversion of a CLG into a CBS

The CBS is a relatively uncommon structure among all charities, although it has been particularly popular among certain groups, most notably housing associations. It is a corporate structure and so shares the benefit of legal personality with CLGs and CIOs. CBSs are also exempt charities, meaning that they are not registered with the Charity Commission. Instead their principal regulator is the Financial Conduct Authority.

Although a number of housing associations are already structured as CBSs, there are also some that continue to be structured as CLGs. What we have started to see, and we expect to see more of going forward, is those housing associations structured as CLGs converting to CBSs. The reason is that registered charities, such as most CLGs, must comply with the Charities Act 2011 disposal regime when disposing of property.

In summary, this regime requires registered charities to obtain a qualified surveyor's report covering certain prescribed conditions. The report must provide a view as to the best terms reasonably obtainable by the charity, and the charity must advertise the property as advised by the surveyor to ensure those terms are obtained. As exempt charities, CBSs do not need to comply with this regime.

There are also other exemptions from the regime, and housing associations which are structured as CLGs have until recently generally been exempt from

complying with these requirements. However, because of changes introduced by the Housing and Planning Act 2016, housing associations structured as CLGs will be required to comply with the regime unless another exemption applies.

The intent of the Charities Act disposals regime is clear and sensible. It exists to ensure that charities get best value for their property so that they can best fulfil their charitable purpose. For many charities, the disposal of a property is a rare and significant event. However, housing associations can have very large property portfolios, numbering in the tens of thousands of units, and disposals are a necessary part of their everyday work.

The concern is that having to now comply with the Charities Act disposals regime will lead to a significant increase of costs for housing associations and interfere with the work they do. Some housing associations structured as CLGs are therefore now converting to become CBSs, to become an exempt charity which is not subject to the Charities Act disposal regime. We expect that we will see more and more of these conversions in the near future.

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