

## **UNINCORPORATED VERSE INCORPORATED STATUS**

### **Unincorporated or Company Status?**

Charities must be properly constituted. This involves adopting some kind of legally recognised form/structure. Broadly this involves a choice between being unincorporated or being incorporated. Charitable associations and trusts are unincorporated bodies and all registered companies and industrial and provident societies are incorporated.

Traditionally, most charities in Scotland have chosen the form/structure of an unincorporated association or charitable trust. However, the responsibilities placed on those in management or control under the 1990 Act are leading increasing numbers of bodies to opt for incorporation because of the greater protection it affords. Also, the increasing deregulation in company law in contrast to the increased regulation of unincorporated bodies can make company status attractive even to smaller charities. The increasing harmonisation of company law in the European Union may open up further opportunities to incorporated charities.

The main reason for those involved in setting up a charity to choose incorporation is the benefit of limited liability status. The limited liability company has a "legal personality" quite separate from its members or office bearers. Therefore the limited liability company will be responsible for meeting its commitments rather than the members or officers.

On the other hand members of the voluntary management committee of an unincorporated association can have unlimited personal liability. Where there are substantial financial commitments involved with the organisation it may be beneficial to opt for incorporation, otherwise, should things go wrong, debts may have to be met from members' own resources.

On the other hand, incorporated status can be seen as complex, expensive and inflexible. In the past this has dissuaded small or medium-sized organisations from choosing that particular legal form/structure. This has led them instead to opt for what is still the most common form of organisation within the voluntary sector, the unincorporated association. This form/structure certainly has more flexibility since there are no statutory rules governing the kind of structure to be adopted, and its constitution may simply be a minute of the first meeting of those involved. However, the requirements imposed by the 1990 Act and the subsequent accounting regulations have narrowed the differences between incorporated and unincorporated bodies. It is advisable to look at all the issues involved before deciding which legal form/structure to adopt since it may prove expensive and difficult to change status at a later date.

The legal form adopted by a charitable body may not always be a matter of choice. Charities may find that important funders, such as local authorities, may insist upon incorporation.

The Companies Act 2006 has now been passed, the Act is expected to be fully in force by October 2008 but some provisions are being brought into force earlier. It is important to seek professional advice in order to understand how this may affect a charitable company and to establish whether it may be of benefit to a voluntary organisation/charity to ultimately adopt an alternative legal form, for example a Scottish Charitable Incorporated Organisation (SCIO).

## **Unincorporated Association**

The unincorporated association is the most common form of organisation within the voluntary sector in Scotland. An unincorporated association is a contractual relationship between the individual members of the organisation, all of whom have agreed or "contracted" to come together for a particular charitable purpose.

Unlike an incorporated body the association has no existence or personality separate from its individual members. There should be at least a written record or minute of agreement which is adopted by an association as its constitution. This is necessary in order to become a recognised charity. A more detailed constitution may be advisable.

Normally the constitution will deal with the appointment of office-bearers such as a chairperson, secretary and treasurer and the election of members of the voluntary management committee. The duties, powers and responsibilities of those appointed and elected will normally be set out in the constitution, as will rules governing membership.

The authority of the office-bearers and the voluntary management committee derives from the contractual agreement between the members of the association. The office-bearers and the committee simply act as agents of the members, exercising the powers and duties delegated to them.

Over time the members of an association may wish to alter its purposes or the arrangements for the conducting its affairs. Unless there are any express rules governing the changing of purposes or rules it is presumed that changes can only be made with the consent of all the members of the association. Any such changes will normally be made at an Annual General Meeting (AGM) or an Extraordinary General Meeting (EGM) of the members of the association.

Because an unincorporated association has no personality separate from its members the property and assets of the association cannot 'belong' to the association. Where the association has been formed purely for the benefit of its members, the assets will normally belong to the members in equal shares. On the other hand, if the association exists to benefit others, the property will normally be deemed to be held in trust for the purposes of the association.

Members of the voluntary management committee and the wider membership of an unincorporated association may be personally liable for any legal actions or debts facing the organisation.

## Becoming a Company

In theory companies can be incorporated with either unlimited or limited liability, but a charitable company would normally opt for limited liability.

The limited liability company can take one of two forms: a company limited by guarantee or a company limited by shares. The main difference between the two is:

- a company limited by guarantee has members who do not make any payment to the company but simply guarantee to pay its debts. Under this arrangement the maximum extent of the members' liability is limited to an agreed amount, usually £1 per member
- a company limited by shares has members or shareholders who purchase shares in the company and have their liability limited to the value of shares purchased.

Charities with substantial financial commitments such as salaries for employees and lease or rental payments are likely to benefit from limited liability status.

The company structure normally used for a charity is a company limited by guarantee, although a company limited by shares may be used for a subsidiary trading company.

Both forms of limited liability company are established through registration with the Registrar of Companies at Companies House. As part of the incorporation procedure two documents must be lodged with the Registrar of Companies, the memorandum of association and the articles of association, which is the company form of organisational constitution. There is an initial incorporation fee payable to the Registrar and also an annual cost in being a company. It is advisable when drafting memoranda and articles of association to consult your professional adviser.

The memorandum of association specifies, often in great detail, what the company may do and what its objects are. It is important to ensure that these are compatible with at least one of the heads of charities. The articles of association are essentially the internal regulations of the company and regulate such matters as the convening and conduct of meetings and appointment and removal of directors.

When a new charitable organisation opts for incorporation the procedure is as outlined above. When an existing charitable organisation decides to change its status and become a company the procedure is different. A new body will be formed and then the entire assets and undertakings of the existing charitable body are transferred to the new company. This transaction must be carefully handled and any organisation contemplating changing status should obtain appropriate professional advice.

The provisions of the Companies Acts are applicable throughout the UK. There are implications for the way accounts are presented and an Annual Return to Companies House must be made.

The Companies Act 2006 will mean real changes for many aspects of company law. It is important to seek professional advice in order to understand how this may affect a charitable company and to establish whether it may be of benefit to a voluntary organisation/charity to ultimately adopt an alternative legal form, for example a Scottish Charitable Incorporated Organisation (SCIO).

## **Scottish Charitable Incorporated Organisation (SCIO) (Act Reference: Sections 49 to 64)**

### **New Charity Law in Scotland: The Charities and Trustee Investment (Scotland) Act 2005**

If you haven't already done so, please read our page 'New Charity Law: Introduction and Overview' before reading further (see link below).

#### **Overview**

The main purpose of a SCIO is to give a charity the benefits and legal protection of an incorporated body - specifically the limited liability of its 'members' - but without the hassle associated with being a limited company or some other type of incorporated body. This has widely been seen as a beneficial move.

Of course, each individual voluntary organisation / charity will have to assess its own circumstances when deciding whether or not to become a SCIO but SCVO expects that for many organisations – especially small or medium sized ones – the SCIO will come to be considered the most appropriate way of incorporating.

The rules that apply to a SCIO - insofar as it has charitable status - are pretty much the same as those that apply to any other charity. In other words the charitable status of a SCIO means that it falls under everything else that applies to charities in the Act. The Office of the Scottish Charity Regulator (OSCR) will regulate SCIOs and approve applications to become one. SCIOs will appear on the Scottish Charity Register.

Anyone thinking of becoming a SCIO should read the relevant sections of the Act and seek appropriate advice if necessary, either from voluntary sector support bodies or the legal profession. Don't forget to check out the Scottish Executive's information on SCIOs (see link below).

It is currently anticipated that it will not be possible to become a SCIO until 2010 at which time there will be detailed regulations produced about SCIOs. Some aspects of SCIOs are not yet clear. For example, it is not quite clear whether, should a SCIO wind up, its assets would need to be transferred to another SCIO or simply another charity. Over time, a combination of regulations and advice/guidance from OSCR should clear this type of thing up.

#### **SCIOs:**

- SCIOs must pass the charity test - including the public benefit requirement.
- The membership of a SCIO may, but need not, consist of or include some or all of its charity trustees.
- Rather like charitable companies limited by guarantee, SCIOs need to be very clear in their founding documents (constitutions) about who can be a *legal member* of the SCIO and how they become one. It is only sensible to thereafter keep a record of who actually *is* a member. This is because *members* of a SCIO have specific legal duties in relation to the SCIO. The duties of charity trustees are set out in Section 66 of the Act. Under section 51 *some* of these duties rest with the *members* of the SCIO. So, in a SCIO the *members* are under the same

duty as the charity trustees to seek to ensure that the SCIO acts in a manner consistent with its purposes. A breach of that duty is considered to be misconduct. Please see our page on “Duties of Charity Trustees” for further information.

- If a SCIO has its charitable status revoked it stops being a SCIO. This is different from charitable limited companies where, once charitable status is revoked, the non-charitable company stills exist as a legal entity, even if it has no reason to carry on. In the case of a SCIO it would revert to an unincorporated voluntary organisation. This would have implications for its assets. Please see our page on “Removal from the Scottish Charity Register and Protecting the Assets of a Charity” for further details.
- You can't be a SCIO *and* another type of incorporated orgainsation (e.g. a company) at the same time – its one or the other. When an organisation converts to being a SCIO it is removed from other registers (e.g. at Companies House)
- Companies and Industrial and Provident Societies (IPS) can, in most cases, convert to SCIOs (see section 56 of the Act).
- OSCR must consult the registrar of whichever form the organisation currently has (i.e. Companies House for companies & the Financial Services Authority for IPS) and 'other persons as it thinks fit' before it decides to grant or refuse a conversion. It can turn down application for conversion based on the results of this consultation even if the SCIO would satisfy the charity test.
- SCIOs can amalgamate with one another.
- SCIOs can transfer their assets to another SCIO and wind up.
- If OSCR decides that a SCIO must be removed from the Register (i.e. cease to be a charity and therefore a SCIO) then the same provisions apply to its assets etc as they do for any other charity
- Third parties have rights in relation to SCIOs. They basically mean that a SCIO can be taken to court if the SCIO or its trustees have acted outwith their powers.
- It is an **offence** not to make it clear on documentation that a SCIO is a SCIO. This offence is punishable by a fine not exceeding level 3 on the standard scale, which currently (January 06) is £1000.