

Changing your charity's structure

We often advise clients seeking to change from an unincorporated structure into a corporate charity.

Lucy Rhodes explains what's involved.



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Lucy is recognised as Key Lawyer and rising star in *Legal 500*. She is a charity law specialist with a varied practice, advising on a range of legal issues that affect charities and not-for-profits of all sizes.

Under English law a charity can exist in a number of legal structures, the most common being the trust, the unincorporated association, the company and the charitable incorporated organisation (CIO).

Although there are many charitable trusts (which are unincorporated) and unincorporated associations around, it is unusual to set up a new charity with an unincorporated legal structure today. The advantages of an incorporated legal form – a distinct legal personality and limiting the trustees' exposure to personal liability in respect of liabilities to third parties – have made the company limited by guarantee and the CIO more attractive options.

Many existing unincorporated charities choose to change to one of these incorporated structures to benefit from these advantages. There is no magic button to press to bring about this change. A new incorporated charity must be established and registered with the Charity Commission. It is then a matter of identifying the assets and liabilities of the existing charity through a due diligence exercise and transferring them over to the newly-registered corporate charity.

Although this process can be technically complex and involve some time commitment from trustees and staff (if any) it does provide an opportunity for a 'spring clean' of the charity. In the due diligence and transfer processes, knotty legal, accounting and practical issues that have not been considered for some time will often be untangled. The new charity will benefit not only from the advantages of corporate status, but also from an up-to-date constitution that facilitates compliance with charity law and good governance practice.

So, if you are embarking on this process, what are some of the key things that you should be thinking about?

Choice of legal structure

Your first decision will be to choose a new legal structure for the charity. By far the most common charitable incorporated structures are the company limited by guarantee and the CIO, but the activities, history and status of your charity may make it worth considering other options, such as the community benefit society or the Royal Charter body.

The main distinction between the company limited by guarantee and the CIO is that the company is subject to company law as well as charity law, whereas a CIO is only subject to charity law. A CIO has a single regulator, the Charity Commission, whereas the company is subject to dual regulation by Companies House and the commission.

The company does have its advantages though, particularly if you are looking for a 'tried and tested' legal form that third parties, including overseas partners, will be familiar with. It can also be set up in a day, whereas a CIO is only established on registration with the Charity Commission. The Charity Commission has been known to register charitable companies in the same timeframe, but this is not the norm.

New layer of governance?

The internal governance structure of your charity may need to change if you change your legal structure. Companies and CIOs have two tiers of governance, with trustees (who, in the case of a charitable company, are also directors of the company for the purposes of company law) and members.

The trustees and members can be the same individuals (the 'foundation model'). This is often the simplest governance model from an administrative perspective, as only one group of individuals is involved, albeit making decisions wearing different 'hats'.

Alternatively, the members can be a wider group of individuals (the 'association model'), a sole individual or a sole

corporate entity, providing an additional layer of scrutiny and accountability for the trustees.

Legal authority

Another early consideration will be whether your unincorporated charity has legal authority to make the change. The first place to check is your governing document, which may have an express power. If not, it may be possible to add one through an amendment. Alternatively, small charities with annual income below £10,000 may be able to rely on the statutory powers in the Charities Act 2011, which require a degree of Charity Commission involvement. In some cases it may be necessary to seek a Charity Commission scheme to authorise the transfer if authority cannot be obtained elsewhere.

What to do with the existing charity?

The tidiest option is to wind up and remove the existing charity from the Charity Commission's register of charities after the transfer to the new incorporated charity has taken place, but this is not always advisable. For example, where the unincorporated charity is likely to receive legacy income, keeping the unincorporated charity as a shell charity on the register can prevent any legacy left to the unincorporated charity being lost once the unincorporated charity ceases to exist. Charities that have valuable trust property that they wish to protect (such as collections with historic or artistic value) may decide to keep the charitable trust alive to hold the property and limit its availability to creditors of the incorporated charity.

If the existing unincorporated charity is retained, it is common for the incorporated charity to be appointed as its sole trustee to enable the individual trustees to retire.

Mechanisms to effect transfer

There are a number of mechanisms available to effect the transfer of assets

and liabilities from the unincorporated charity to the incorporated charity. In most cases a transfer agreement can be used, although certain arrangements require bespoke documentation to be put in place.

For example, transfers of registered land must be in a prescribed form and submitted to the Land Registry for registration, and contracts with third parties may need to be transferred by a deed of novation.

Consents and consultation

It is essential to factor in plenty of time to obtain any consents and carry out any consultation that may be required.

For instance, Charity Commission approval will probably be needed if there is overlap in the trustees of the original charity and the trustees of the new charity. The charities may also need to obtain consents from third parties before transferring particular assets, for example, from a lender that has a mortgage over land to be transferred or a landlord whose lease contains covenants against assignment. And if the original charity has staff, the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) will apply to the transfer process. Among other things TUPE imposes duties on the charity to inform and, if applicable, consult in relation to the transfer.

FIND OUT MORE

The Charity Commission has recently updated its guidance on changing your charity's structure <https://www.gov.uk/guidance/change-your-charity-structure>

Our Charity and Social Enterprise team has significant experience of advising charities on the pros, cons and process of change and would be happy to discuss your particular situation with you.

