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## Factsheet/Advice Sheet No. 8

# Legal Structures for Community Activity

## July 2007

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This is one of a series of Factsheets for voluntary and community groups issued by West Norfolk VCA.

It offers a quick overview of the different legal structures which are available (with some of their advantages and disadvantages), and some issues around trading, and personal liability..

We have made every effort to ensure accuracy, but cannot be held responsible for decisions you take based upon our guidance. You are advised to take expert legal advice as appropriate.

### 1. Why do we need to bother with legal structure?

Your organisation needs to have a structure

- So that decisions get made, and action taken
- For accountability
- For democratic reasons
- To fulfil its purposes.

Many organisations in the Voluntary and Community Sector, particularly small ones, are what is called an “unincorporated association”, and make their administration as simple and practical as possible.

You may choose to do nothing about the issues raised in this factsheet.

Even so, in the eyes of the law, the officers of your organisation are deemed to hold personal responsibility for their actions. Signatures on cheques and documents could be shown in a court of law.

As an organisation takes on more responsibilities, people start to worry about the burden of responsibility. This is where choosing the appropriate structure becomes important.

### 2. Possible structures

Some of the possible structures are

	Main features
*Unincorporated association	A group of people with a common goal Simple set of rules, or constitution. The Management Committee has overall charge.

	Individuals are held responsible or “liable” if anything goes wrong.
*Company limited by guarantee	<p>A group of people with a common goal</p> <p>The rules and aims are set out in “memorandum and articles of association” – has to register with Companies House, and send reports, and notify changes.</p> <p>Directors of the company have overall charge.</p> <p>Company is an entity for legal purposes – this limits the personal liability of officers/trustees - individuals usually pledge £1, and that is the limit of their liability.</p> <p>Can obtain “charity” status by applying to the Charity Commission.</p> <p>Can develop trading opportunities</p>
*Co-operative	<p>Activities are done for mutual benefit of the members (members can achieve something together which they couldn’t do separately)</p> <p>Controlled by its members</p> <p>It is an Industrial &amp; Provident Society – regulated by the Financial Services Authority, and can secure “charity” status from Inland Revenue.</p>
Community Interest Company	<p>Trading activity benefiting the community.</p> <p>Must have defined “social” aims, and this is protected by a mechanism called an “asset lock”.</p> <p>Trading and making “profit”</p> <p>Surpluses (or “profit”) invested back into the organisation and/or new activities.</p> <p>Pays full taxes and rates, and cannot be “charitable”.</p>
Development Trust	<p>Partnership organisation, which typically brings together voluntary/community organisations, local authorities, and businesses</p> <p>Normally independent of the organisations which set it up – relationships set out in a partnership agreement</p> <p>Has its own asset-base, or trading facilities</p> <p>Able to meet its own core costs</p>

There are two other commonly used descriptions of organisations

Social Firm, or Social Enterprise	<p>This is not a defined structure – it is a generic term for organisations with characteristics of</p> <ul style="list-style-type: none"> <li>• Social ownership</li> <li>• Trading</li> <li>• Social objectives</li> </ul> <p>Activity benefiting the community</p> <p>Trading and making “profit”</p> <p>Members, employees, or service-users come from the disadvantaged/beneficiary community</p>
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	Will adopt a structure as appropriate, eg. company limited, co-operative, community interest company. May or may not be charitable.
*Wholly owned subsidiary of a voluntary/ community organisation	Undertakes trading activity under the ownership and control of the parent organisation – sometimes called a trading arm. Will have its own structure, eg. company limited, co-operative, community interest company.

### 3. Charitable status

Those marked with \* are able to take on “charity” status.

Charity Status has the advantages of :

- tax benefits
- fundraising benefits
- image and credibility with the public.

The main disadvantages/problem areas are

- can't pay trustees, except under certain limited conditions
- can't change aims or rules without permission from Charity Commission
- trading is only allowed
  - if in direct pursuit of the objects (ie. the stated aims of the charity).

### 4. Trading

Charities can carry out trading activities

- where they contribute directly to their objects (ie. the stated aims of the charity), or
- where they raise funds for the charity and do not involve significant risk.

Such activities will be exempt from corporation tax, so long as the profits go to the purposes of the charity.

If trading activities make a loss, the Trustees will need to answer for whether they made a sensible decision to enter into trading.

Note : charities are able without restriction to sell or hire donated goods. This does not count as trading, and is zero-rated for corporation tax and VAT.

Examples of trading activity by charities are

- sale of goods manufactured by disabled people – by a disabled persons' charity
- sale of tickets for a theatre production by an arts or theatre charity
- sale of books, promotional pens, mugs and tea towels by a museum charity
- coffee/sandwich shop run by community centre.

Conducting a lottery counts as trading. However it is exempt from corporation tax, so long as it complies with section 3 (small lottery), or section 5 (society's lottery) of the Lotteries and Amusements Act 1976.

Any organisation, charitable or not, must register for VAT if its trading income exceeds £54,000 per year in any one quarter.

A charity must set up a trading subsidiary

- where the trading activity would involve significant risk to the assets of the charity itself.

It may also be beneficial to set up a trading subsidiary

- so that the administration is separate, or
- to reduce tax liabilities. However you should seek detailed advice on this.

Trustees should always put the interests of the parent charity first.

## 5. Liability

**Trustee liability** - in a company limited, individuals only have limited personal liability if things go wrong – usually limited to £1.

Unincorporated Associations (most voluntary organisations) don't offer this protection. As a result Trustees (Management Committee members) can be personally liable to

- Make good losses resulting from their actions
- Be responsible in law for failings of the organisation.

The best ways to reduce risk/liability are to

- Act honestly and reasonably
- Act within the governing document (constitution, or memorandum and articles of association)
- Seek (financial and legal) information and advice before making decisions
- Declare an interest where appropriate
- Ask Charity Commission advice when in doubt.

It is also possible to take out Trustee Indemnity insurance – see below.

**Risk assessment** – charities with income over £100,000 are required to confirm in their Accounts that they have assessed and mitigated the major risks to the charity.

**Trustee indemnity insurance** can help protect Trustees in situations where genuine mistakes were made in

- Using funds outside the charity's objects or powers, or
- Making poor investments.

It will not cover for

- Losses where Trustees acted dishonestly, or in (reckless) disregard of their responsibilities
- Liabilities to third parties e.g. breach of contract, redundancy payments, negligence
- Penalties/fines for breach of statutory duty.

Some people argue that Trustee Indemnity Insurance is a waste of money, because

- it only covers aspects which most groups would be unlikely to have problems with, and
- any serious liability is not covered in any case.

Charity Commission advice is

- Undertake proper risk assessments
- Provide good internal procedures, to prevent the need for Trustee Indemnity
- If you do consider taking out Trustee Indemnity, check the policy carefully to be sure that the cover obtained is worth having.

## **6. Further useful information**

The Hallmarks of a Well-run Charity – Charity Commission publication CC60.  
The Essential Trustee: what you need to know, publ. June 2005 by Charity Commission.

Trustees, Trading and Tax – Charity Commission publication CC35.

Value Added Tax – charities, publ. January 2005 by HM Customs & Excise.

Voluntary but not Amateur: a guide to the law for voluntary organisations and community groups, publ. October 2000 by London Voluntary Services Council.

Voluntary sector Legal Handbook, publ. 2001 by Directory of Social Change.

[www.governancehub.org.uk](http://www.governancehub.org.uk)

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