Charity and voluntary sector restructures

Keith Wallace explains how and why charities and voluntary bodies may restructure

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Keith Wallace is a consultant at Reed Smith
reedsmith.com

Charities and voluntary bodies need to restructure for a variety of reasons: this article discusses the 'how' but we must start with the 'why'.

OFFICEHOLDER PERSONAL LIABILITY

The personal exposure of officeholders in association, club or trust deed structures will be familiar to practitioners. A recent illustration of this is *Monir v Wood* [2018] EWHC 3525. An unincorporated association's chairman devolved management of the entity's Twitter account to a third party, who libelled an outsider. The latter chose to sue, alone, the chairman, who was found personally liable for the vicarious defamation and suffered a judgment of £40,000.

Contract-wise, the alert treasurer may sign a large contract on terms that exclude his personal liability, or cap payment liability to the association's available funds. Torts are different. They strike from a clear blue sky and one cannot pre-contract with a hitherto unknown victim.

Charities find themselves devolving jobs to third parties who impose a ceiling on their liability. If the contractor causes loss to third parties, the officeholders may be liable for the entire amount, but only able to recover up to the contract cap. Then there is the 'deep pocket' risk that a creditor or claimant selects the wealthiest officeholder or trustee alone, and obtains judgment and redress in full, leaving the luckless individual such civil rights of 'contribution' as can be recovered.

FUNDER AND DONOR ATTRACTIVENESS

Grant-makers, funders and foundations have their own tastes and requirements. Some misconceptions prevail that charities may only make grants to other charities. This is not so, of course, but possession by the awardee of 'registered' charity status is often a determinant.

Public money tends to be more concerned with the presence of tight governance and accountability, some assurance over 'asset lock' or effectual hypothecation of the award to the stipulated purpose but, again, registered status may be a factor.

TAX OPTIMISATION

Availability of Gift Aid is a compelling need for entities who might qualify to reclaim it. Low and standard-rate tax payers may themselves be indifferent to Gift Aid, but higher-rate payers are not, since they may claim higher rate relief for themselves on their Gift Aided donations.

Indeed, it is this class who will be tempted by the Capital Gains Tax (CGT) and Inheritance Tax (IHT) freedoms on gifts to charities. A higher-rate payer may donate a gain-showing investment to charity (neither the party paying CGT) and get a tax deduction for the entire value of the gifted shares).

At operational level, charities value the tax exemptions accorded to them and any otherwise taxable 'trading' surplus can be sheltered by being confined to a trading 'subsidiary' which smartly donates its surplus upward to the parent charity. Charities pay a reduced rate of 5 per cent of Value Added Tax (VAT) in certain circumstances, for example – day care or heating oil; zero VAT on, for example, ambulances, talking books, lifeboats and the like; and may import certain goods free of VAT as well.

A less frequent reason for change is to modernise one's legal purposes, area of benefit or constitutional terms generally. These rarely need a new legal structure, being accomplished by a Charity Commission Scheme, permitted amendment or (rarely used) a High Court Scheme.

In considering some perceived need for registered charity status, it must be borne in mind that registration merely confirms charitable status. Absence of registration does not mean the converse. An entity may be charitable in law (while unregistered) because it:

- is too small to register
- has simply omitted to register
- is exempt or excepted (Charities Act 2011)
- is forbidden to register (ie registered societies, the former friendly societies), or
- is denied the facility for registration by diktat of the Charity Commission (domestically operating but subject to non-English law).

An alternative route to obtaining official recognition of charitable status is

by application to HMRC. The process is undemanding and opens the way for Gift Aid recovery and the other tax benefits. Quoting "HMRC recognised charity reference XYZ" on the charity's letterhead, sign off and website ought to go a long way to reassuring donors.

HOW TO RESTRUCTURE

The usual move is to incorporate a trust deed, club or association charity. This meets the officeholder personal liability threat and also provides the (contractual and property) 'perpetual succession' convenience of a single ongoing entity. Laymen can't understand that one can't contract 'with' a trust or a club; nor the problems caused by the repeated entrance and exits of trustees or officeholders.

The choice falls between a company limited by guarantee (COLG) and a charitable incorporated organisation (CIO). For the both there are entirely adequate model constitutions available. Use of these reduces friction at the registration stage – and they provide the predictability of legal outcome to which practitioners aspire.

In adapting a model constitution one then only needs to focus on a few variables; the legal purposes; and the mode, term and expiry of trustees, for example.

For an existing, well-established charity, either a COLG or a CIO may be used. The double annual filing which a COLG entails (Companies House and Charity Commission) is very minor – say one hour's extra work a year after the first.

For a fledgling or start-up charity, the CIO is best avoided for two reasons: a CIO has no legal existence until it is registered. Hence the entity may not contract, open a bank account or pass any resolution until then. Since registration of a CIO by law denotes charitability, the Charity Commission interrogate the applicant requiring it to "prove" it is charitable and has all the functioning attributes of an established entity – a logical impossibility which the Commission ignores. With a COLG one has a legal entity at the point of incorporation at Companies House so operations can be started while awaiting the later formality of Charity Commission registration.

Thought needs to be given to moving the assets and engagements across to the replacement structure. Pinning down all the old charity's contracts may be impossible. In practice it rarely seems to matter. The bank and auditors may need new mandates or engagement terms while other suppliers rarely do.

Note that there is a statutory machinery in the Charities Act 2011 for charitable companies (including companies limited by shares), registered societies and community interest companies to convert to CIO status. Using this route will have the effect of passing all contracts and engagements to the new CIO.

Remember to note the replacement on the register of Merged Charities: this ought to help pass across legacies from the old vehicle to its replacement in years to come, as well as avoiding confusion since the replacement is likely to use the same name.

The old and the new body are also likely to have the same officeholders – this is after all just a commendable shift of structure. So be aware of a recent obiter dictum in *Lehtimaki and others v Cooper* [2020] UKSC 2018/0150 by Lady Arden which could suggest that the identity of officeholder in both bodies might pose some disabling conflict. This has never troubled the Charity Commission nor practitioners.

A similar consideration of 'conflict' could be present where the new structure can facilitate the old structure's officeholders against late emerging claims (see CC OG 531-1). Since any outgoing fiduciary has always been entitled to reserve his right of recourse against the transferred assets, recognition of this latter facility meets the need in practice, anyway. SJ

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