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BRIEFING PAPER

Trust or Company

A guide to the differences between the two structures

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TRUST OR COMPANY?

A guide to the differences between the two structures

1. If you plan to set up a new charity, you currently have a choice between two main structures. These are:-
 - (a) The Charitable Trust (with a Declaration of Trust or Trust Deed as the constituting document) or
 - (b) A Charitable Company limited by guarantee (governed by Memorandum and Articles of Association)
2. Both are equally charities, they simply have different legal structures. Both can provide the full range of charitable objects and powers that you may need. With either structure, the trustees remain subject to general charity law and must always act with appropriate care and must keep within the charitable objects and powers. Trustees (directors) of a charitable company are, of course, also subject to the Companies Acts and various company law requirements.
3. As a general point, a Trust is simpler to administer and cheaper to establish and operate. The chief attraction of the company structure is that it provides protection for the individual trustees/directors from personal financial liability in some circumstances where trustees of an unincorporated charitable trust would not be protected.

4. Contractual Obligations

Where a charity employs staff or holds a mortgage or takes on any other contractual liabilities, it should consider incorporating. This would give the charity the benefit of limited liability through the company structure. The charity would benefit from being a separate legal entity where its assets are at stake and not the trustees/directors individually should it become bankrupt. The Directors are responsible for ensuring that the charity meets with the requirements of both Companies House and the Charity Commission at all times.

5. The Liability Issue

- 5.1 There are two sets of potential liabilities that charity trustees face:
 - (a) The first is in respect of the **duties owed to the charity** to act with the necessary care and not to act outside the objects and powers of the charity . If trustees cause a loss to the charity, either through a lack of proper care or by spending money for purposes outside the charity's objects, they can be called upon to refund the money out of their own resources. This applies as much to directors of a charitable limited company as to the trustees of an unincorporated charity.
 - (b) The second set of liabilities has to do with **potential claims by third parties**. Examples of these would be: claim for damages for personal injuries; claim for compensation for unfair dismissal by an employee; claim for breach of contract by a supplier of goods and services (e.g. building contractor on a building project); claim for damages in respect of "wrong" counselling advice. It is in respect of these potential claims that protection is afforded to trustees of a charitable company.

- 5.2 In the case of a company, a separate legal entity exists. This means that any debts owed by the company are owed *by the company* and not by the trustees personally. (This assumes that the trustees have not given personal guarantees or entered into contracts in a personal capacity). In the case of a Trust, there is no separate corporate entity, and therefore the debts and potential liabilities of the charity, which cannot be met out of its own resources, can become the liability of the trustees personally.
- 5.3 It should be added that in the case of a company, if the directors/trustees continue to operate whilst knowing that the company is insolvent, they could then become personally liable for debts owed by the company.

6. **Holding Legal Title**

As a company exists as a separate legal entity, legal title to buildings, stocks and shares etc., can be held in the name of the company and not in the names of the trustees for the time being. This saves legal costs and fees associated with a change of legal title of land/buildings when trustees change. But note that it is possible to incorporate a body of trustees of a charitable trust so that legal title can be held in a corporate name. This is called a trust corporation. However, this does not give the trustees the protection of limited liability.

7. **Formalities, Filing Requirements, Penalties**

- 7.1 The charitable trust structure has the benefit of great simplicity. Trust Deeds usually leave the trustees to decide how often they meet and how they convene their meetings etc. They ought to keep minutes of their meetings, although this is not a formal legal requirement.
- 7.2 Companies face stricter requirements under the Companies Acts. An AGM has to be held at the right time with proper notice given of the time and place and the business to be transacted. Annual returns and notices of changes of directors or secretary or registered office have to be notified to Companies House within certain time limits. Accounts must be sent to Companies House within strict time limits. Late filing of the annual accounts brings an immediate fine of £100, which increases if the delay is more than three months. There are specific requirements regarding details to go on Company notepaper.

8. **Accounting Requirements**

The requirements are broadly similar for charitable trusts and charitable companies in that the Charities Accounting Regulations have placed equally onerous requirements to keep accounting records and to produce annual accounts to certain standards on both unincorporated charities and charitable companies.

Charities and charitable companies with an annual turnover in excess of £500,000 will require a full audit. For charities and charitable companies with annual turnover of less than £500,000 but with fixed assets totalling 2.8 million or more – an audit will be required.

For charities and charitable companies with turnover and fixed assets under these limits, an independent examination at the appropriate level will be required.

9. **Set-up Costs**

If you use our services, the cost of setting up and registering the charitable company is more than that of registering a charitable trust

because of the additional and more complicated documentation and the need to make application both to Companies House and the Charity Commission. The cost of incorporating an existing charity is slightly higher than for registering a new charitable company to reflect the advice and support required during the process.

10. Legacies

The Charity Commission now takes the view that a charitable company is a successor body to the original charity. If a gift is made to a dissolved unincorporated charity it would take effect as a gift for the purposes of the association. A statement showing that the new body is succeeding the original charity and that the charitable objects are the same may be included within the Memorandum and Articles.

11. Contracts

Following incorporation, all contracts and assets will need to be transferred to the new entity. Contracts of employment are transferred automatically but pension rights will not unless the pension scheme so allows.

N.B. The CIO – Charitable Incorporated Organisation

The Charities Act 2006 contains a proposal for a third entity – the Charitable Incorporated Organisation (CIO). The draft framework is covered in the Act, however the detail is subject to secondary legislation and we do not have a precise time-scale for this at present except that it should become available during the course of 2009. Please contact us if you would like any further details. It is proposed that the CIO will offer all the benefits of a charitable company (limited liability, legal entity) although it will only require to be registered with the Charity Commission. Our advice is that only existing charitable companies can convert directly to the CIO. Charitable Trusts will have to set up a new entity and transfer its assets across before winding up the original Trust.

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