

Constitutions 1: Incorporation or not?

These notes cover the basic issues to be considered when a voluntary group starts to consider whether to become a limited company.

Clarifying the language:

There are a few points about terminology which you need to be familiar with:

- Organisations which have not registered as limited companies are called “**unincorporated associations**”
- The process of creating a company of any kind is called “**incorporation**”
- The “**memorandum and articles of association**” is the special form of constitution used by limited companies
- The terms “**Board**”, “**Board of Directors**”, “**Board of Trustees**”, “Management Committee”, Council of Management” etc are more or less interchangeable. You can call the group which governs your organisation whatever you like.

Don't panic

The decision to register as a limited company is often worrying for new groups. It really does not need to be a traumatic experience if you go about it methodically.

- it's perfectly natural; lots of people are doing it all the time
- there's plenty of experience for everyone to follow among existing community and charitable groups, and there are many advisors in the voluntary sector
- you do **NOT** need to spend money on a solicitor to register your company, unless you have an unusual and complicated structure – in which case, the only solicitor who can help you will probably be a specialist in company registrations for the voluntary sector. (In fact, in Community Projects Centre's experience, the company constitutions which cause most problems for voluntary sector organisations have usually been drawn up by solicitors.)

What IS incorporation?

- **Limited companies are legal entities:** Registering your groups as a limited company changes the legal status of the people who are running it. Unincorporated associations (groups which have not yet registered to become limited companies) are regarded in a legal sense as a number of separate individuals who are each personally responsible for the activities of the organisation. But the law regards a company as a single thing, which is separate from the people who are running it. In the unlikely event of legal action of any kind being taken against a community-owned company, it is the company which will probably find itself in court rather than directors in a personal capacity.
- **Limited liability protection:** By far the most common type of company in the voluntary sector is a “company limited by guarantee”. Unlike other types of company, there is no shareholding. So the members do not stand to lose their investment – just a *limited* sum of money (usually £1) which they have *guaranteed* to pay if the company is unable to pay its debts. *In short, members are not personally liable for their company's debts.*

- **The formal structure:** Incorporation as a limited company *requires an organisation to take on a particular formal structure* – but this is not be very different from the structure used by most unincorporated voluntary groups. It will include rules about issues such as:
 - general membership of the company: (these are the people and organisations who have the power to elect or appoint the directors, although the board and the wider membership are sometimes identical)
 - who can be a company member
 - the size and make up of the Board
 - Board and company meetings
 - what to do with the assets if the company is wound up
 - other optional issues such as reports, conflicts of interest, and details of the way directors are appointed or elected.
- **A formal public status:** The company has public responsibilities – to put details of its directors and accounts on file at Companies House.

When is incorporation a good idea?

The decision to form a limited company and timing the registration is a matter of choice for the group. But there are a number of circumstances related to issues such as protecting the organisation's assets, protecting members from personal liability, and needing to be seen as publicly accountable which are likely to influence this choice. Groups should seriously consider registration if they answer "yes" to any of these questions.

- are there substantial assets to protect - eg a building?
- do we have significant employment responsibilities?
- are we taking legal responsibilities which make it more appropriate for us to have a collective identity – eg a building lease? (in unincorporated organisations it is common for two individual members to be required to sign lease agreements and other contracts on behalf of the group, and this level of personal responsibility may well be seen as unfair or unreasonable)
- are we getting involved in business activities where our trading activities could be creating a significant new risk for members?
- will it genuinely improve our image with funders and supporters? (groups should be careful about coming under pressure from officers in public bodies who do not really understand the voluntary sector, though in most cases there will probably be no harm in following their advice).

What time is best?

- **Too soon:** Some organisations choose to register as limited companies from the very start, ie before they have become active. That is not necessarily a bad approach, but discussions about the memorandum and articles and responsibilities of directors can sometimes be a distraction for a new group, and they may also put off potential members.
- **When the scale of activities is appropriate:** It may be better to leave incorporation to the time when the real needs for company status listed above are becoming apparent. It should be a relatively quick process, so there may be little need to do it a long time in advance.
- **Before registering as a charity:** One time when it definitely is a good idea to think in advance is when the limited company also expects to seek registration as a charity with the Charity Commission. If you register an unincorporated association as a charity and afterwards become a limited company you will, in effect, have to re-

register the charity. In these circumstances it may well be less complicated for a new organisation to register from the beginning as a company limited by guarantee with a set of memorandum and articles which is recognised as charitable, rather than to start off as an unincorporated charity which is converted to a company at a later stage. This basic advice is unlikely to change with the introduction of the new all-in-one Charitable Incorporated Company.

What type of company:

These notes do not cover the different types of company structure available. But it is important to recognise that:

- While there is a growing number of options for voluntary organisations to choose from, the basic principles of incorporation remain the same for all of them. See section 2 for more information about the options, including:
 - ordinary company limited by guarantee without share capital
 - ordinary company limited by shares
 - Community Interest Company limited by guarantee
 - Community Interest Company limited by shares
 - Charity Incorporated Organisation (when they are introduced)
- Some types of limited company can also be charities; if you are thinking of registering as a charity as well you will need to weigh up the pros and cons and the constitutional options for charity status as well as for companies.

Pros and cons

- **Advantages of registering a limited company:**
 - **a legal entity:** This is sometimes useful to separate the role of the group members from the
 - **guaranteed liability:** This gives the members of the governing group some, but not complete, protection against them becoming personally responsible for losses if the company runs into trouble. (The directors cannot escape from the obligation to act properly in the interest of the company.)
 - **good practice:** The knowledge that their organisation is legally and publicly accountable helps to ensure that directors/trustees stick to the good practice in their activities (which they should be using anyway, of course).
- **Disadvantages of limited companies** The main disadvantages, compared with unincorporated associations, are:
 - the possible additional costs of preparing annual accounts
 - the requirement to appoint a Company Secretary who is responsible for dealings with Companies House
 - the small amount of additional bureaucracy involved in meeting the requirements of company law, backed up by automatic fines for non-compliance – sending accounts and lists of directors to Companies House every year
 - a modest extra cost of the initial incorporation (£20-£35, depending on the type of company)
 - the requirement that the names of trustees and the accounts are available for public inspection
- the sense of unease which some committee members in small organisations misguidedly feel about being called “directors” or about their “legal responsibilities”. (Their legal responsibilities, with guaranteed liability, are hardly any greater – and they can call

themselves what they like in their memorandum and articles of association, including “committee members”.)

What’s involved?

There are a few basic steps:

- make the decision to incorporate – do this at any time
- decide *when* to incorporate
- choose an acceptable name which is sufficiently different from other existing registered names, which is not legally restricted, and which you are confident will not cause conflict with users of similar trading names (see Companies House guidance)
- draw up the memorandum and articles of association – use a model set of rules (these are available from your local council for voluntary service, the Charity Commission, and other umbrella organisations or associations)
- apply to Companies House (or to the Charity Commission for a Charity Incorporated Organisation).

Contact

Company formation packs, information leaflets and Companies House forms are available from:

Companies House
Crown Way
Cardiff
CF14 3UZ

Phone: Companies House Contact Centre 0870 3333 636
Web site: www.companieshouse.gov.uk.

*Community Projects Centre
October 2006*

Constitutions 2: Options for legal structures

These notes describe the options available for producing constitutions and legal structures for community and voluntary organisations.

Clarifying the language:

In the legal structures the following terms are used to some extent interchangeably:

- “constitution”
- “memorandum and articles of association” – refers to limited companies
- “trust deed” – refers to charitable trusts
- “rules” (usually refers to Industrial and Provident societies)
- “governing document”
- “governing instrument”.

Legal structures for beginners

Government efforts to reform charity law and help (albeit in a small way) social enterprise organisations are complicating what was already a somewhat perplexing array of choices for inexperienced community and voluntary organisations. It is immediately a matter of concern for many people when they start to consider “legal structures” that they must deal with something with apparently major implications beyond their current experience. On top of that there seem to be so *many* options to weigh up – requiring a string of either/or decisions, not a simple choice from a list. Information alone may not be not enough. Sometime what’s really needed is reassurance. Here’s a start.

- **You already have legal responsibilities:** If you are doing anything as a community or voluntary group with other people you already have “legal responsibilities”. *Getting formally constituted does not expose you to greater risk – it helps you to manage your responsibilities better.*
- **The basic legal distinction** is between:
 - **unincorporated associations** – as a committee member you are personally responsible, with the other members, for what your organisation does, whether or not you have a written constitution
 - **all types of limited company** (and industrial and provident societies) – your organisation has a separate legal identity; as a director or committee member you are responsible for running it properly, and if you do you will not be liable for its debts
- **Basic types of limited company:** There are three distinct forms of company which are defined by their form of ownership. Any other types of legal structure you will come across will be variations of one of these three – which is why the choices seem to be so complicated
 - public limited companies (you don’t need to worry about these)
 - companies limited by shares
 - companies limited by guarantee.
- **The new legal structures:** Two new types of legal structure are being introduced by legislation to meet the needs of the so-called “Third Sector” in the 21st Century. They are not entirely new, just revamped versions of the three basic company models above.
 - **Community Interest Companies**, designed for social enterprise activities, may take the form of companies limited by guarantee, companies limited by shares, or public limited companies

- **Charitable Incorporated Organisations** which will be a new form of company limited by guarantee which has charitable status “built in” – ie it removes the need for the two stage process of registering the limited company and then the charity
- **Charities are separate:** Charities may take a variety of forms, and can perhaps be seen as a kind of overlay on these different arrangements, so some are limited companies and others are not. Depending on the individual details of their constitutions, the following types of organisation may apply for and be granted charitable status by the Charity Commission in Wales and England:
 - unincorporated associations
 - charitable trusts
 - charitable companies limited by guarantee
 - Charitable Incorporated Organisations.

More about the options

Before you write a constitution you will need to make a fundamental decision about what type of organisation you want. It is not necessarily important at this stage to decide whether you want the organisation to be a charity. That decision can come later when you get to the detail of drafting the constitution.

- **Unincorporated associations** include very many small locally-based groups, clubs, projects *etc* which provide community services or services to their members.
- **Companies limited by guarantee** tend to include larger voluntary organisations or groups with assets to protect. They operate under a variety of titles, which invariably have no specific legal meaning. The variety of titles they include in their names indicates the very wide range of organisations which companies limited by guarantee can be used for in the voluntary sector – for example, “not-for-profit organisation”, “community partnership”, “community centre”, “development trust”, “community business”, and “co-operative”, “charitable company”.
- **Companies limited by shares:**
 - **as the main lead organisation:** A few community projects have used this structure to attract an “investment” from local residents and supporters – which may or may not offer the possibility of a dividend. In practice, selling shares has sometimes been used as a way of raising grants. But this can be extremely misleading for investors, and may backfire, even if the legal implications are properly covered. It can also be complicated to make companies limited by shares operate democratically, so they are not ideal vehicles.
 - **as the trading subsidiary:** Companies limited by shares are used much more widely as wholly-owned subsidiary trading organisations by charities, development trusts and other social enterprise ventures. The most common format is for the parent organisation (often a company limited by guarantee, but it could be a Community Interest Company) to own the only share issued by the subsidiary, and to appoint one or more directors from its own board. The parent company could also appoint its own Chief Executive to be a director (even if it is a charity).
- **Less flexible formats:**
 - **Industrial and provident societies** enjoy some of the benefits, and experience some of the constraints, of companies. Some are charitable. They are often regarded as an old fashioned and somewhat cumbersome vehicle, and are not covered here.
 - **Trusts** are an older form of often charitable organisation which establish a relationship between three groups of people: *donors*, who agree to entrust money or property to *trustees* who manage them for the benefit

of *beneficiaries*. They can be rather inflexible and are not generally used today by voluntary and community organisations.

- **Newer legal structures:** The Government has introduced two new legal structures which will be of interest to voluntary organisations. The intention has been to create new company arrangements which will be easy to convert to from existing company structures.
 - The **Charitable Incorporated Organisation (CIO)** are a special type of company with charitable status. I
 - The **Community Interest Company (CIC)** has been introduced by the Department of Trade and Industry to help “social enterprise” organisations which operate for public benefit to register new companies easily and cheaply and to *provide protection for their assets and profits* when they attract outside investments. The memorandum and articles of association specifies that their assets are “locked in” so they cannot be distributed to members or transferred to another company other than a charity (as is the case for charities). CICs must make an annual report to the Regulator demonstrating that the company is run in the public interest. They do not enjoy any of the tax benefits of charities.
- **Charities:** *Organisations with most of these structures may also be charities.* (The main exceptions are companies limited by shares and the Community Interest Company). Charity status is a separate major issue, and is not considered here in detail. It is not relevant that the trustees may *consider* their work to be charitable; they only become charities in Wales and England when they are recognised by the Charity Commission.

When to choose an unincorporated association

If you want simplicity and flexibility, and you will not be taking responsibility for property or substantial sums of money, an unincorporated association could be the structure you need. An unincorporated association is a group of people who come together to pursue a shared aim. It is especially well suited to membership organisations, where it is important for the members to have a close involvement with the running of the organisation. It is typically used by self-help groups, local societies, and local campaigning organisations.

- **Advantages of unincorporated associations:**
 - are simple to set up and inexpensive to run
 - are very flexible because the constitution can be tailored to suit the needs of the organisation
 - can allow control to lie in the hands of either the membership as a whole or a smaller group of trustees (frequently called the “management committee”) elected by the members, or even a small group alone without the need for a membership
 - may have a constitution which can be changed relatively easily, usually subject to the approval of a certain percentage of its membership
 - have considerable independence and freedom of action (if they are not registered charities) – for instance, they do not have to submit accounts to outside bodies.
- **Disadvantages of unincorporated associations:**
 - have no legal personality, so they cannot directly hold property and may find it too difficult to borrow money – legal transactions have to be in the names of the trustees and cannot be carried out in the name of the organisation (you will need to appoint a small group of holding or custodian trustees who hold the assets in their names)
 - give trustees no protection against unlimited personal liability, *ie* if the association has insufficient assets to pay its debts, the trustees will personally have to pay them (in exceptional cases the personal liability can extend to the wider membership)

- can be susceptible to abuse by trustees, *eg* to reduce the democratic rights of members.

When to choose a company limited by guarantee

When voluntary organisations form companies, the type of legal structure they normally use is the “company limited by guarantee”.

- **What is a company limited by guarantee?** In a company limited by guarantee:
 - the company members have equal voting rights (in other types of company their voting rights are likely to depend on the number of shares they hold)
 - instead of holding shares (which imply financial risk) the members’ *liability is limited*.
- **Voluntary organisations as limited companies:** Technically, the governing document, or memorandum and articles of association, of a company limited by guarantee can allow the trustees (“directors” or “board members”) considerable flexibility. The format described in these notes is the one which applies most commonly to *voluntary* organisations. Slightly different provisions can allow workers in some co-operatives to control their companies and benefit financially as trustees. Companies limited by guarantee are usually recommended where trustees will be:
 - employing more than one or two members of staff, or
 - handling large sums of money, or
 - entering significant contractual arrangements with outsiders.
- **Guaranteed liability:** Companies limited by guarantee are private companies with a membership instead of shareholders. The members all guarantee to pay a nominal maximum sum, usually £1 or £5, if the company becomes insolvent – that is, liable for debts which cannot be repaid from the charity’s assets. As company members, trustees will not be personally liable for the debts of a company above the nominal sum they have guaranteed except in exceptional circumstances. So they are particularly well suited to volunteer directors in community organisations and charities.
- **Charities as limited companies:** *However, the trustees of companies which are also registered as charities can still be held personally liable by the Charity Commission for any breaches of trust, such as spending the charity’s assets on a project which is outside the scope of their activities as defined in their memorandum and articles of association, or making bad investment decisions without obtaining advice.*
- **Community Interest Companies limited by guarantee:** There are probably only minor benefits (and a small amount of extra cost and bureaucracy) for small community and voluntary organisations becoming established as Community Interest Companies. But they are well suited to expanding social enterprise organisations which have significant assets to protect and need to attract private investors to support their development.
- **Pros and cons of company status:** See Section 1 “Incorporation or not”.

More information:

The following web sites are extremely useful:

Companies House: www.companieshouse.gov.uk/

Community Interest Companies Regulator: www.cicregulator.gov.uk

Charity Commission: www.charitycommission.gov.uk

The Community Projects Centre Information Sheet *vvv* also covers the option of choosing the right legal structure for your needs

Constitutions 3: Contents of a constitution

A typical constitution

What it consists of: A typical governing document covers the following issues:

- **aims and objectives** (the “objects” clause): that is, what you aim to do, and who will benefit (the beneficiaries)
- **area of benefit:** this describes the local, regional, national or international geographic area you will cover (it may be included in the objects clause)
- **powers:** what you are allowed to do in order to pursue your aims and objectives (see below)
- **membership:** who can be a member of the organisation, how they join, subscriptions and how membership is terminated
- **general meetings of members:** rules for holding and running annual general meetings and other meetings
- **the Managing Committee:** rules for the election to the committee, and procedures for running the committee, the maximum and minimum size, different classes of committee member, the appointment of officers
- **finance:** rules for managing money and property
- **alterations:** how to change these rules
- **indemnity:** a clause sometimes included to indemnify board members out of the assets of the organisation against liabilities incurred through doing their job properly (but not, for registered charities, in the case of breach of trust, fraud, *etc*)
- **dissolution:** how to wind up the organisation.

The format of the memorandum and articles of a company limited by guarantee

The constitution of a company guarantee is called its memorandum and articles of association. Company law is explicit about items which it must contain.

The memorandum of association states:

- the company's name
- the location of its registered office
- the objects or aims
- the fact that members' liability is limited
- the size of the members' guarantee
- the powers of trustees to achieve the objects
- special powers, such as provision for worker-trustees or power to use the company's assets to pay for trustee liability insurance
- details of what happens to the assets if the company is wound up.

The articles of association give the rules and regulations which govern the internal proceedings of the company. These usually include:

- who can become a member of the company
- the number of trustees, how they are elected or appointed, for what period, and any restrictions on who can become a trustee

- procedures for holding meetings, including annual and extraordinary general meetings, and voting;
- financial and auditing procedures
- procedures for appointing auditors
- powers to delegate to staff or subcommittees
- administrative provisions, *eg* notices, indemnities, standing orders.

Constitutions 4: Drafting charitable “objects”

Good practice in drafting the objects clause

The objects clause states the objectives of your organisation. For charities the objects can only refer to the particular types of activity which are recognised by the Charity Commission as charitable. See the Charity Commission website for more information on drafting the objects clause.

An example objects clause: A group planning to run a community centre which gives priority to activities for young people might combine general and specific objectives in their objects clause, for example:

The objectives of the organisation shall be to advance education, to relieve poverty, sickness and disability, and otherwise to improve the quality of life of people living in Stonybroke (the area of benefit), and in particular to:

- 1. provide facilities for young people to advance their education, health and wellbeing*
- 2. provide facilities for public recreation and cultural activities for the benefit of the community.*

There is no need to go into greater detail since that could prevent the organisation from responding to unexpected funding opportunities or changing their priorities if community needs change.

Charitable objects for non-charities: It can be a great advantage for community and voluntary organisations which choose not to register as charities to have an objectives clause which is strongly community-minded or altruistic *in its intent*. Potential funders, supporters and the public are likely to feel much more kindly disposed to an organisation which defines itself in terms which reflect a charitable ethos, even if it would not be eligible for registration – for instance, because it has been set up to carry out trading activities. (Groups should be aware that, strictly speaking, organisations with wholly charitable constitutions are required by law to register as charities. In practice very many do not.)

Pitfalls: It is easy to get the objects clause wrong, so care is needed.

- **Activities outside the objects:** It is a breach of trust for a registered charity to act outside your objects, *eg*, in the example above, to provide facilities for people living outside Stonybroke.
- **Including everything:** Groups drafting their objects are often tempted to list in detail every particular charitable activity they want to pursue, in the belief that this will impress funders or potential supporters. This approach often leads them to include activities which are unacceptable to the Charity Commission because they are not actually charitable, and to deny them flexibility if they want to expand into related activities later. Generalised objects can be more useful. It also creates a massive challenge to justify everything you say you will do in your application for charity status.

- **Confusing objects with powers:** The objects are the primary purpose of a charity; its powers provide the means of achieving that purpose, and are not in themselves charitable; employing counsellors and publishing leaflets may be essential to a bereavement charity, but they are not objects.
- **Setting aims without means:** Charitable objects alone cannot ensure that a new charity will be accepted by the Charity Commission. You will need to demonstrate that the organisation has the necessary powers, organisational capacity and access to resources to do its job. This is one means for not making the objects clause *too* general.

More information

The Charity Commission provides comprehensive information at www.charitycommission.gov.uk about starting and running a charity, including drafting constitutions.

Constitutions 5: Drafting the “powers”

The “Powers” clause

Objects and powers: A common mistake in drafting constitutions is to mistake the powers of an organisation with its objectives. The “objects” are the purpose the organisation was set up for; the “powers” are the means of achieving the objects. This distinction may not matter much until you attempt to apply for charitable status, but they will be rigorous. A conservation organisation may want to raise money and publish a newsletter to publicise its work. But the Charity Commission does not recognise publishing or fundraising as charitable.

The importance of the powers clause: In the above example, the groups objective is to promote conservation, but it will need to give itself authority in the “powers” clause to publish and fundraise. It is important to ensure that an organisation has all the powers it is likely to need to do its job in the future, and it is not always easy to predict what these are when you are just starting out. The power to own buildings, for instance, may easily be overlooked at a time when a group can barely afford to buy postage stamps.

A sample list of powers The governing document is likely to list the powers available to the trustees to enable them to carry out the objects. The following powers may be included in your governing document:

- to co-operate with other bodies and people to achieve your objects
- to promote or set up services such as homes, clinics, hostels *etc*
- to promote or form other bodies or organisations which can help the organisation
- to improve or increase the knowledge or understanding among the general public on the issues which the organisation is concerned about
- to print, publish and distribute literature relevant to the organisation
- to purchase or take on a lease of premises; also to equip, sell, buy, manage, develop, let, furnish, mortgage property, *etc*
- to obtain and receive money by way of donations, contributions *etc*
- for a company, to act as a trustee for other bodies
- to invest money, and to borrow or raise money
- to transfer property or assets belonging to the organisation
- to promote changes in the law or acts of parliament in order to pursue the objects
- to join or be part of other bodies whose objects are similar
- to provide welfare for the employees or ex-employees
- to be able to insure the trustees against personal liability
- to do anything else that will help with the attainment of the organisation’s objects (an all-embracing clause found in many government documents).

Working within your powers: Trustees must ensure that organisations do not act beyond their powers. Technically, they can be challenged legally if they spend their organisation’s money without authority, and could be required to repay what they have spent from their own pockets. It is usually better for a new organisation to include a comprehensive list at the outset to avoid problems later, though you should be careful not to take on powers that are wholly inappropriate for your work.