

## **KSAM Briefing Note**

**February 2011**

### **LEGAL STRUCTURES FOR TRADE ASSOCIATIONS**

**Contact: Rob Johnson (Operations Director)**

**rjohnson@kingstonsmith.co.uk**

There are several different legal forms which a trade association may choose to adopt in order to carry on its daily business. This paper gives a brief introduction to these, and highlights some of the pros and cons of each.

#### **Private company limited by shares**

This is the most common vehicle for an entity wishing to make a profit and enjoy the benefits of limited liability. To set up as a limited company, a company has to register with Companies House and is issued with a Certificate of Incorporation. It also needs to have Articles of Association which set out what the company has been formed to do and are internal rules over including what the directors can do and voting rights of the shareholders.

It has a separate legal identity from the persons forming it – i.e. its directors and shareholders. This in turn means that it can enter into contracts, employ staff, own property and commence and defend legal proceedings in its own name.

There is a division of power between board meetings where, generally speaking, directors' decisions are made, and shareholder meetings, where, generally, shareholder decisions are made.

The shareholders' liability is limited to the amount that they have paid or agreed to pay on their shares. As long as the business is operated legally and within the terms of the Companies Act, directors or shareholders personal assets are not at risk in the event of a winding up or receivership

#### **Private company limited by guarantee**

A company limited by guarantee is an alternative type of legal entity used primarily for non-profit organisations that would prefer to have corporate status. A company limited by guarantee does not have a share capital but has members who are guarantors instead of shareholders.

These guarantors give an undertaking to contribute a nominal amount (normally £1) towards the winding up of the company in the event of a shortfall upon cessation of business.

A company limited by guarantee cannot distribute its profits to its members. This means that it is eligible to apply for charitable status if it so wishes.

Companies limited by guarantee are often used by charities and for not for profit promotion of education, commerce, art, science and sport, or for promoting the interests of a particular section of society, or for a particular policy.

As with a private company limited by shares, a company limited by guarantee is a legal entity which exists separately and distinct from the individuals who are involved in it. Consequently, it can sue, or be

sued in its own name, enter into contracts and own property in its own name. As long as the business is operated legally and within the terms of the Companies Act, members' personal assets are not at risk in the event of a winding up or receivership

## **Unincorporated Associations**

Many trade associations are already established as unincorporated associations.

The key criteria for an unincorporated association are that it should: (i) consist of two or more persons with a common non-business purpose; (ii) have contractual relations between those persons; (iii) be governed by rules; and (iv) be non-temporary.

Unlike private limited companies, unincorporated associations are not normally subject to outside legal controls. For example, there is no central register or regulator for unincorporated associations, nor are there statutory requirements that dictate how they are, or should be, run.

However, it must be borne in mind that an unincorporated association does not exist independently of its members. It therefore cannot hold property or enter into (or carry out or be sued in relation to) contracts in its own name. It is not possible to contract with the unincorporated association itself nor is it possible to contract with the members.

Individuals contracting on behalf of the association may be personally liable or they may be acting as agents for the members. Even when a member purports to act as agent for the association, he may be personally liable if he has not made sure that he has authority to contract as an agent either through the rules or with the express written consent from the other members.

## **Community Interest Company**

A Community Interest Company (CIC) is a limited liability company, designed for social enterprises that wish to use their profits and assets for the public good. A CIC has the specific aim of providing a benefit to a community and must use its income, assets and profits for the community it is formed to serve.

CICs may be companies limited by shares or by guarantee however they must satisfy (and continue to satisfy) a "community interest test".

It should be noted that a CIC cannot be a political party, a political campaigning organisation or a subsidiary of a political party or political campaigning organisation. Moreover, a CIC cannot be a charitable company (but a charity may own a CIC). To become a CIC, a company must pass a "community interest test" by providing evidence in the form of a community interest statement.

The community interest statement is intended to demonstrate that a reasonable person would consider that the CIC's activities are being carried on for the benefit of the community or a section of the community.

In terms of limiting liability, a CIC also has 2 main statutory restrictions – namely an asset lock and a dividend cap.

The asset lock is designed to ensure that ensures that the CIC's assets are not sold at an undervalue and are used for the benefit of the community it was initially set up to serve and not to benefit the company's members, directors or employees. This means that the company cannot generally transfer

its profits or assets for less than their full market value except as permitted by regulation. It is also designed to protect any remaining assets for the community if the CIC is dissolved.

The ability of a CIC to pay dividends to shareholders depends on the constitution of the specific CIC. As discussed previously, a CIC which is a company limited by guarantee does not have any shareholders and so cannot pay dividends.

CICs with a share capital can only pay dividends out of distributable profits. Unlike most companies however, CICs may only declare a dividend by ordinary or special resolution of the members. The directors are unable to declare a dividend without consulting the members and gaining their support.

The dividend cap preserves the principle that the CIC's assets benefit the community by ensuring dividends are not disproportionate to the amount invested by the investor or the profit generated by the CIC. It has three elements which are (i) a maximum dividend per share; (ii) a maximum aggregate dividend (which is currently 35 per cent of distributable profits); and (iii) an ability to carry forward unused dividend capacity from year to year to a limited extent (currently the limit is five years).

The liability for any person involved in a CIC will be the same as that for involvement in a Company limited by guarantee or shares.

## **Charities**

A charity is not a type of legal form or structure: it is a status conferred on a group of individuals or an organisation because of the activities it carries out. Thus Charities can adopt a number of different legal structures – they may be unincorporated associations, a trust or a company limited by guarantee (it is rare that a charity will be a company limited by shares).

Moreover, every charity must have a governing document that sets out the charity's objects and how it is to be administered. Charities are restricted in that their objects must be exclusively charitable and they cannot, except in certain circumstances, carry out or fund activities or undertake permanent trading which falls outside those objects. To overcome this, a separate non-charitable subsidiary company is often established to carry out such activities, and directs its profits to the parent charity.

Once registered, charities are under the auspices of the Charity Commission (CC). Those that are registered as companies have to comply with company law too.

The advantages of becoming a charity are that it will receive relief from Income Tax, Corporation Tax; Stamp Duty, Capital Gains Tax and Inheritance Tax, and will qualify for Business Rate Relief. Furthermore, being registered as a charity demonstrates that the organisation is a lawful charity and therefore subject to the CC's jurisdiction. This in turn may enhance in the public a sense that the organisation is reputable.

The main disadvantages of being registered as a charity are the increased regulatory burden (e.g. strict requirements on the keeping and filing of accounts). Moreover, as most charities are subject to the CC's jurisdiction, the CC has wide powers in terms of the investigations and recommendations it can make which include the removal and replacement of trustees. Charity Trustees may also be held to be personally liable for misappropriation of funds.