

The Charity First Series

STRUCTURING NOT-FOR-PROFIT OPERATIONS IN THE UK

Julian Smith
and
Elizabeth Jones

FARRER&Co

The Charity First series aims to provide practical and straightforward guidance on the challenges confronting charity operations today, with fundraising in the spotlight. Its individual subjects range from those concentrating on the UK and Ireland to non-profit issues in the EU and other jurisdictions, from traditional to digital fundraising and from basic help for those just entering the third sector to specialist areas for the more experienced.

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This sample consists of brief extracts from one title in the series.

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The publication from which this material is taken was first published electronically in 2012 by Social Partnership Marketing LLP
38 Leconfield Road, London N5 2SN

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Full version: ISBN 978-1-908595-14-0

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INTRODUCTION

Not-for-profit organisations use a number of different legal forms in the UK. This guide describes the different forms of not-for-profit organisations that are available, how each can be established, and some factors you will wish to consider when getting a charity (or other not-for-profit) up and running. The guide then goes on to consider briefly the position of foreign not-for-profit organisations, how such organisations may operate directly in the UK and the pros and cons of setting up a new, UK based organisation.

‘Not-for-profit’ is a term frequently used in the UK but one that does not have a precise technical definition. Broadly speaking the term means an organisation established for a purpose other than that of making a profit, where some or all surplus revenues are used to further that purpose of the organisation rather than to benefit those with an interest in the organisation. References to not-for-profit organisations in the UK will frequently mean a charity, but can also include a wider group of organisations with purposes other than to make a financial gain.

Although a not-for-profit organisation can adopt various forms in the UK, broadly speaking the UK tax system only recognises three basic types:

- Charities, which are exempt from most direct taxes, and which donors can support tax-effectively;
- Community Amateur Sports Clubs (or ‘CASCs’), which have some tax reliefs and which can offer limited tax reliefs to supporters, but are beyond the scope of this work; and

- Other not-for-profit bodies (including community interest companies), which receive no preferential tax treatment and are liable for taxes in the same way as a commercial business.

This guide is primarily concerned with charities, which are by far the most common form of not-for-profit organisation in the UK.

The legal regime for not-for-profits varies across the UK, with different legislation applying in both Scotland and Northern Ireland than the regime in England and Wales. This guide focuses on England and Wales. The three regimes are similar, although there are important differences notably in the definition of charity, which is slightly different in Scotland and Northern Ireland.

1

BACKGROUND

Overview – The three types of not-for-profit organisation – Key features of being a charity - Introduction to charity tax - Regulation of charities in comparison with other not-for-profits

Overview

This section defines the three types of not-for-profit organisation commonly used in the UK and describes the legal and tax regime applicable to each.

The three types of not-for-profit organisation

Company limited by guarantee and others

A not-for-profit organisation will typically have objects that are for a purpose that is not private gain, which could include running a society for the benefit of its members, or have a benevolent or philanthropic purpose that is not charitable.

Not-for-profit organisations may be established as a company, trust or unincorporated association, and their constitutions often share many characteristics with charities. Not-for-profit organisations typically have a governing document preventing the distribution of assets for any purpose other than the purpose of the organisation and have a focus that is unrelated to a commercial business.

There is no regulator of not-for-profit entities that are neither community interest companies nor charities, and such entities are treated in the same way as commercial companies for tax purposes.

Community Interest Company (CIC)

CICs are a type of company that have objects that are for the community benefit (this is different from charitable objects) and have a governing document containing particular features required pursuant to the CIC legislation. One of the key features of a CIC's governing document is that it has an 'asset-lock', preventing distribution of its capital assets to its members or for any purpose other than the (community benefit) purposes of the CIC.

CICs are relatively new, having only been available since 2005. Although becoming more common, CICs are still not widely used. CICs are intended to offer a suitable form for social enterprises and not-for-profit entities that did not qualify for charitable status but that wanted to have a not-for-profit brand. CICs are used for the most part for small scale enterprises, many of which contain a trading or commercial element that a charity would not be permitted to undertake.

CICs can be established as companies limited by guarantee and be not-for-profit entities. CICs may also be established as a company limited by shares and make distributions out of profits to shareholders, although a cap is set by government on the amount. This enables CICs limited by shares to pay some returns to investors, while retaining most of the profit to re-invest into the CIC's activities.

CICs are regulated by the Community Interest Company regulator, which is a light touch regulator. CICs are required to file an annual report to the regulator, alongside providing accounts to Companies House and must obtain the regulator's consent to make particular changes to its governing document.

CICs receive no preferential tax treatment, and are treated as normal commercial companies for tax purposes.

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About the Authors

Julian Smith is a Partner at Farrer & Co who has specialised since 1994 in advising philanthropists, charities and other bodies operating in the not-for-profit sector. He writes and lectures regularly on matters relevant to charities and is a part-time lecturer on charity law at the Cass Business School. He is the co-author of ‘The Charities Act 2006: A Practitioner’s Guide’ and consultant editor of Peter Luxton’s ‘The Law of Charities’, published by Oxford University Press. Julian is a member of the Executive Committee of the Charity Law Association and is also chair of its Standing Committee on Taxation, which responds to tax consultations of relevance to the voluntary sector.

Elizabeth Jones is an Associate at Farrer & Co who advises a diverse range of charities on constitutional matters, mergers and re-structuring and governance issues. Elizabeth has spent six months on secondment at a national museum acting as sole legal adviser and she has recently been involved with two cases on public benefit that were heard in the Upper Tribunal. She is a charity trustee and regularly writes articles and speaks on legal issues affecting the sector.

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Full version: ISBN 978-1-908595-14-0