

## **Mergers of Charities**

### **Introduction**

Mergers are increasingly becoming a feature of the voluntary sector. The pressure for this comes for a number of different reasons. In some cases there is external pressure from funders. The shift in funding to contracting, particularly in areas like community care where larger organisations can have significant advantages in winning contracts, is often a factor. The Charities Acts included wider powers to enable small charities to be merged. In some cases the two charities wish to avoid duplication of effort or to rationalise where there are already close connections. Larger charities are also increasingly considering merger as a means of broadening the base of their activities. As in all issues involving charities, the charity trustees of all the charities involved in the merger must take independent appropriate professional advice and be satisfied at all stages that the merger is in the best interest of the charity and of its present and future beneficiaries. The public often criticise the sector for duplication of effort but diversity has its own benefits and mergers will not automatically result in increased funding and may lead to loss of volunteers or donations as loyalty often attaches to the individual charity rather than the charitable objects.

### **Procedures to be followed**

Merger between two or more charities involves a number of complex legal issues and it is important that the charities should seek separate legal advice at an early stage. The first question to be asked is whether the merger is legally possible; does the charity have powers under its own constitution to transfer its assets to a successor charity or will the Charity Commission's powers need to be utilised? The merger will normally be effected either by winding-up one charity with the transfer of its assets and operation to another (transfer of engagements) or by creating a new charity, winding-up both existing merging charities (a true merger). In both cases, the legal procedures which need to be followed depend very much on the legal structure concerned. There are a wide variety of other alternative solutions, the most common being one organisation becoming a subsidiary of the other or both becoming subsidiaries of a new holding company (a group structure).

### **Trusts**

Charitable trusts normally include dissolution clauses and the power to transfer property to other charities or amalgamate with other charities. Older trusts will sometimes have no power to spend capital, in which case the property is classified as permanent endowment and cannot be transferred to another body unless the small charities provisions in the Charities Act 1993 apply. In this case the transferee will normally be appointed as trustee of the transferor, in effect the trust becomes the subsidiary of the transferee. Even if there is a

dissolution clause in the trust deed this sometimes directs that the funds should be transferred to a named charity in which case the named charity and the Charity Commission will need to be approached and a merger may not be possible.

### **Unincorporated Associations**

The procedure to be followed in an unincorporated association depends on whether there is a dissolution clause. Most modern constitutions will contain one, but if there is not, then the Charity Commission will need to be consulted.

### **Charitable Companies**

There are usually fewer problems in mergers involving charitable companies as the Memorandum of Association will normally include power to amalgamate with other charities having similar charitable purposes.

### **Other Legal Structures**

If the charity has a more unusual structure, such as incorporation by Royal Charter, Industrial & Provident Society benevolent society or is established by Charity Commission scheme the procedures will be different.

### **Compatible Objects**

Whatever the legal structure, a full merger will be easiest if the two charities have compatible objects. Quite often the acquiring organisation will have broader objects (and indeed, if they are substantially narrower a merger would not be possible). In this case, the assets of the acquired charity would normally need to be 'ring fenced' (only used in accordance with original charitable objects). If the objects of the two charities are not entirely compatible in the case of an unincorporated charity an application would need to be made to the Charity Commission for a cy pres order.

### **Alternative Solutions**

Where a full merger is not possible one alternative solution is to have common trusteeship. A corporate charity appointed as a trustee by the Charity Commission will automatically be a trust corporation and may thus act as sole trustee. Retaining the two charities with common trusteeship will involve some practical difficulties. Another possible solution is that the Charity Commission may treat two or more charities with the same trustees as a single charity.

In the case of two companies the charity taking over can become the sole member of the other company or a new holding company or parent can become the sole member of both charities.

## **Constitutional Changes to Acquiring Charity**

Once the necessary legal powers to effect the merger have been clarified, you will need to consider whether constitutional changes need to be made to the acquiring charity. If a new charity is to be set up you can start from scratch with the constitutional arrangements and a new charity may well be appropriate where a change of legal structure is required, for example, incorporation. If one charity is, however, to be the successor body, far reaching changes may need to be made to the existing constitution in a number of areas. Firstly, a change of name may be considered to reflect expanded activities and the merger itself. Secondly, expanded operations may require additional powers. Thirdly, there will probably need to be changes to the governance with representation from both charities. In practice, this is often one of the most difficult areas to negotiate. Lastly, the membership provisions will need to be re-examined. There may well need to be new categories of membership or criteria for eligibility and the whole size of the membership may well also need to be reviewed.

Membership cannot be transferred. All members of the merging charity will need to be approached to complete new membership application forms.

## **Funds Held on Special Trusts**

Additional problems will arise where the merging charity holds funds on special trust.

Where small funds are involved, it may be possible to use the small charities provisions of the Charities Act effectively to wind-up the Trusts and transfer them to another charity or spend the permanent endowment. The Act permits the expenditure of permanent endowment in some circumstances.

## **Transfer of Assets or Undertaking. Due Diligence**

The constitutional issues are just some of the legal issues that need to be addressed on a proposed merger between charities. Basically, the merger generally takes two forms. Either there is a simple transfer of assets to the acquiring organisation or, as is most common, there is a transfer of the whole undertaking to the acquiring organisation. The organisations will need to take professional advice and make full investigation of the assets and particularly liabilities and risks that are to be taken on. This will involve looking at such areas as HMRC liabilities VAT; funding and agreements and property. This process of investigation is often referred to as due diligence investigation and professional advisers will be well aware of the issues involved. The question of warranties from individual trustees of the merging charity will need to be considered.

Where doubt still exists after due diligence, or time or resources are too short to allow full investigation, the strategy of taking the transferor as a subsidiary for a quarantine period may be useful. Transfers only then take place later once enough time has elapsed to ensure there are no unknown liabilities.

## **Potential Liabilities of Trustees of Merging Charity**

The merging organisation will need to protect its position and particularly the position of its trustees with regard to any future liability. In the case of an unincorporated charity there will be potential personal liability for the charity trustees. In the case of a charitable company, the company will normally be wound-up using the simple striking off procedure which could render the company directors personally liable for any debts arising after the company has been struck off. The formal winding up procedure protects but is more expensive.

## **Transfer Agreement**

There will normally need to be an agreement between the two charities covering the transfer of assets and the assumption of liabilities and suitable indemnities. The complexity of this agreement will very much depend on the circumstances but does not normally involve the complexity of an agreement for a commercial take-over. There will probably also need to be additional documentation involving the transfer of land, the transfer of investments, of intellectual property, etc. Where third parties are concerned, their consent will usually be necessary and there may need to be the novation (recontracting) of existing contracts. Negotiations with funders will need to take place at an early stage.

## **VAT**

The transfer will often come within the exemption from VAT for the supply of assets as part of a transfer of an undertaking as a going concern.

If the Transferor has opted to charge VAT on any rent, the Transferee will probably need to opt to tax the property at the time of the merger. Failure to do so will lead to VAT liabilities.

## **Winding-Up of Merging Charity or Retention as a Shell**

Once the transfer of assets and liabilities from the merging charity has been carried out, steps will normally need to be taken to wind-up the merging charity. The procedure will depend on the legal structure. In the case of a company, rather than go through a formal liquidation, it is much cheaper and easier to apply to be struck off the Register of Companies. Closing accounts will need to be prepared and these will be sent to the Charity Commission to enable the merged charity to be struck off the register of charities. The main disadvantage of this route is that the company may be reinstated if a liability later emerges. In the case of unincorporated charities, a copy of the resolution winding-up the charity, together with a copy of the closing accounts, will need to be sent to the Charity Commission to remove the merging charity from the Register.

In some cases, rather than wind-up the merging charity, there may be reasons why it should be preserved as a shell or dormant organisation. One reason for this could be where substantial legacy income to the merging charity is expected. It may be possible to protect this by registration of the merger on the Charity Commission Register of Mergers. One disadvantage of retaining the old charity as a shell is that accounting and reporting requirements will still need to be satisfied, but these are fairly minimal as the light touch accounting regime would apply. If the shell of the merging charity is to be retained then amendments may need to be made to the governing instrument.

## **Summary**

These notes are only a very brief summary of a complex area and should not be relied on without legal advice. James Sinclair Taylor is happy to deal with queries.

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