

## Charitable incorporated organisations two years on

### What is a CIO?

A CIO is a legal structure that has been designed specifically with charities in mind.

It is not a company. However there are significant similarities. Like a company, a CIO has trustees and members (akin to shareholders in a company). Members have the final say in constitutional changes and have a range of other rights including the ability to appoint and remove trustees and to vote at general meetings. Also, like a company, the CIO has its own legal personality and the members have limited liability.

CIO trustees, like company directors, are not directly liable for the debts or performance of the charity's obligations. The CIO enters into contractual arrangements itself rather than through the trustees personally.

### Differences between CIO's and charitable companies limited by guarantee

Unlike a company a CIO is only registered and regulated by the Charity Commission and avoids dual registration at Companies House and unlike company directors the trustees do not face the confusion of duties under both company and charity law.

Also, whereas a charitable company limited by guarantee comes into existence when it is formed at Companies House, a CIO does not come into existence until the Charity Commission has approved the constitution and registered it as a charity. So, for example, the founders of the charity cannot set up a bank account until the CIO is registered.

Another difference is that there is an express legal duty on those members of a CIO who are not directors to act in the interests of the CIO. This is not the case for companies and because of this internal disputes between members of charitable companies can be particularly difficult to manage.

### CIOs and unincorporated charitable trusts or charitable unincorporated associations

There are specific regulations for certain CIO governance procedures. There is therefore less freedom to regulate their own procedures than in the case of in the case of charitable trusts or unincorporated associations.

However the CIO structure has some significant advantages over unincorporated charitable organisations.

Charitable trusts or unincorporated associations do not have a separate legal personality, which means that their trustees are parties to any legal agreements or contracts (including employment contracts) on behalf of the charity. Similarly, property and investments must be held by individual trustees or a "holding" trustee.

Trustees can therefore be personally liable, to the extent that anyone suing the organisation will have sue named trustees and serve the proceedings personally on them. Trustees generally find this an unsettling experience.

Although trustees will have a right to be indemnified out of the assets of the charity in respect of any liability they incur in their capacity as trustees, this does not help if the charity does not have the assets to meet the claim. The trustees may have to pay compensation out of their own pocket.

A further disadvantage of the trust structure is that every time a person ceases to be a trustee of the charity, it is necessary to transfer any property held by them and any agreements to a new replacement trustee. This can involve expense and difficulty especially where the charity has failed to effect the changes over time.

Additionally, if a third party with whom the charity has an agreement such as a lease fears that a replacement trustee is not as wealthy as the current trustee, and therefore not as able to meet any claim that they may have (for example payment of rent under a lease), the third party may not be prepared to agree to release the old trustee from the obligation they undertook when signing.

Whilst it is possible to take out insurance policies against certain liabilities, this is often not available, especially with respect to failures on the part of the charity to meet running costs. There is a general perception that the risks and costs associated with such claims, especially employment related claims, are increasing, particularly as the range of employment legislation increases and becomes more complex.

### **Can unincorporated charitable trusts or charitable unincorporated associations convert into CIOs?**

Given the advantages of CIOs over unincorporated charities, many of the latter prefer CIO status.

There is no current or planned mechanism to enable conversion as such.

However, subject to certain conditions and necessary legal procedures trusts and associations can “incorporate” by transferring their assets to a newly established CIO and making appropriate arrangements with funders and suppliers to ensure that in so far as possible the CIO takes on all the functions of the former unincorporated charity.

This is a very popular procedure, and whilst the level of complexity involved can vary greatly from charity to charity, the benefits in particular of limited liability are such that it will usually be worth it.

### **Can companies convert into CIOs?**

The Regulations to allow companies limited by guarantee (whether charitable or non-charitable), community interest companies (CICs) and industrial and provident societies (IPS) to convert to a CIO are still delayed. The Charity Commission has no date set for bringing in the Regulations.

However, the delay does not stop companies from becoming a CIO but it means that any companies looking to do so will instead have to set up a new CIO and transfer its assets to it in the same manner as in the case of an “incorporation” (see above). This is a more complicated process than would be enabled by the provisions for conversion, if they were in force.

## **Applications to register CIOs**

The Charity Commission has drafted a model constitution for CIOs. The Charity Commission generally expects applications for charity registration to follow the model constitution.

In our experience, however, the Commission the Commission is prepared to be flexible and pragmatic with respect to proposed changes, as long as we provide them with sensible reasons for those changes.

It appears from our dealings with the Commission that they will generally accept sensible proposals for changing the standard internal governance procedures.

They are however likely to resist proposals that create a risk of bad governance, such as extremely long trustee terms of appointment.

## **The future of CIOs**

The novelty of the CIO means that there is a learning curve for the Charity Commission, trustees and advisers alike. The legal status and specific regulations applicable to CIOs are new and remain untested by the courts and there are areas where as yet there is no legal certainty.

By comparison, the law in respect of companies is generally well tested and clear. As CIOs are entirely serviced by the Charity Commission, which has undergone severe funding and personnel cuts we have found a little difficulty and delays in trying to complete administration with the Charity Commission.

In addition, CIOs are not yet well known to the wider business community nor other jurisdictions as CIOs are unique to the UK.

There appears to be a degree of wariness on the part of charitable companies limited by guarantee to take these risks in exchange for single regulation.

However, the single layer of regulation and advantages of corporate personality have led to CIO's being the first choice for unincorporated charities wishing to incorporate, or new charity registrations.

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