

Common Good Fund Proposals: Annex 2

Legal structures available to the Fund

1. On the basis of seeking to achieve charitable status for a Fund, the three possible structures for the Fund are: a trust; a company limited by guarantee; or a Scottish Charitable Incorporated Organisation (SCIO).

Trusts

2. A trust involves an individual or body or, more commonly, a number of individuals (the trustees) holding funds and/or property for a purpose which benefits others. The essential point is that there is a document (the trust deed) which specifically states that the assets are being held “in trust” by the trustees for a particular person or persons or for a particular purpose or purposes.
3. The advantages associated with trusts are:
 - a) There are no formal registration requirements with which to comply, meaning that there is no “standard” to maintain, other than those pursuant to its charitable status;
 - b) There is no public record to maintain other than ensuring annual monitoring returns are submitted to the Office of the Scottish Charity Regulator (“OSCR”); and
 - c) There is considerably less administration as compared with a company, as there is no register of members to maintain, no annual general meetings or elections to arrange, and no subscription monies to be collected.
4. The disadvantages associated with trusts are:
 - a) Liability of trustees - a trust does not have a legal identity distinguishable from its trustees for many significant purposes. For example, the acquisition of property and entry into leases and contracts must be done in the names of the trustees at the time and not the trust itself. The position in relation to the liability of trustees is not clear cut. The trustees, as the people holding the trust’s property interest, are potentially exposed to liabilities to third parties. In matters relating to contractual arrangements, given that in carrying out his or her duties a trustee is acting for the trust rather than for him or herself, he or she will normally not be liable in relation to contracts with third parties, providing it is made clear at the time of entering into the contracts that he or she was acting solely in his or her capacity as a trustee. There is, however, a legal principle which states that a trustee is deemed to guarantee that the trust assets are sufficient to meet payments falling due under the contract which could form the basis of a claim against the trustee personally, if the trust was ultimately unable to meet those payments; and
 - b) Strict compliance with the trust deed - a principle of trust law is that trustees have no legal power to do anything which is not authorised by and set out expressly in the trust documentation or principles of trust law. Trustees can be personally liable for acting outwith the scope of the trust deed.
5. If the Fund plans to directly employ staff, rent or lease out property, enter into more complex and/or high value legal arrangements and/or deal with substantial funds then we would not recommend that the Fund adopts a trust structure. Instead, we would recommend that the Fund considers adopting a corporate legal structure in

order to provide greater certainty for the trustees and more effectively manage legal, financial and commercial risks.

Company Limited by guarantee

6. **A company limited by guarantee is a separate legal entity with separate legal personality distinct from its directors and its members. The company has no shareholders and does not distribute profit. Its members' liabilities are limited to a guaranteed sum – usually a nominal amount of £1.00. The company must comply with the 2006 Act.**
7. Until the introduction of the SCIO, the company limited by guarantee model was the most attractive option for charities wishing to enjoy the benefits of limited liability, and organisations found that the administrative burden associated with operating as a company could be easily managed.
8. The relative advantages and disadvantages of a company limited by guarantee model are as follows:

Advantages:

- a) The members of the company enjoy limited liability in that they need only guarantee to pay a nominal sum towards the company's debts if it goes into liquidation;
- b) The company is a separate legal entity from the individuals involved in it - the company is therefore able to directly enter into agreements and leases, acquire property and recruit employees in its own name, rather than in the name of its directors; and
- c) A company structure is familiar to funding bodies and public agencies and consequently such third parties may be more comfortable engaging with an organisation structured in this way.

Disadvantages:

- a) There are formal registration requirements to be complied with in relation to establishing a company, and there are some associated costs;
- b) There are also ongoing administrative requirements in terms of providing notifications to Companies House of relevant changes, for example, a change of directors, company secretary or registered office as well as the delivery of accounts and annual returns. This is in addition to the annual monitoring return which charitable companies must also submit to OSCR; and
- c) It is more expensive than a trust in terms of ongoing costs, particularly where there is an external company secretary or independent auditor.

Scottish Charitable Incorporated Organisation (SCIO)

9. The SCIO is not a company nor is it subject to specific company law rules. It is also distinct from a charitable trust, since the SCIO has separate legal personality from that of its trustees and members. A SCIO is a corporate body with independent legal identity. It is governed by the general charity law rules in Scotland plus specific rules relating solely to SCIOs.
10. The SCIO mirrors the protections afforded to trustees by a company limited by guarantee structure, but unlike a company, it is administered and regulated solely by OSCR.

11. A SCIO is created by registration with OSCR. It may only be used by a charity and would cease to exist if removed from the Register of Scottish Charities. The SCIO must have a principal office within Scotland.
12. The SCIO has distinct requirements as to its formation:
 - a) It must have a minimum of three charity trustees, who will have responsibility for the general control of the SCIO. After registration, corporate trustees are permitted, but a corporate body cannot be an initial trustee. The initial trustees must be “natural persons”;
 - b) It must have minimum of two members, who may also, but need not be, trustees of the organisation. The CNPA would be permitted to become a member after registration, but the initial members must be natural persons. Representatives of the CNPA could be members of the Fund initially;
 - c) Although, in general, members are protected by limited liability, one important difference between SCIOs and all other types of charity is that a SCIO’s members have some of the legal duties of trustees. They must act in the interests of the SCIO and seek, in good faith, to ensure the SCIO acts in a manner which is consistent with its charitable purposes;
 - d) Every SCIO must have a constitution with specified minimum content (set out below); and
 - e) The key condition which must be satisfied before OSCR will proceed to create the SCIO is satisfaction of the “charity test” – the SCIO must have charitable purposes and provide public benefit.
13. In many ways, SCIOs and companies limited by guarantee seem comparable. However, there are important legal differences:
 - a) SCIO members have some of the legal duties of charity trustees (there are no specific legal duties for company members);
 - b) The SCIO has the advantage of being regulated solely by OSCR, as opposed to dual regulation and a dual legal regime, as is the case with companies limited by guarantee with charitable status;
 - c) SCIOs can only amalgamate with other SCIOs (not other legal types of charity); and
 - d) Conflicts of interest must be addressed, at least in outline, in a SCIO’s own constitution (companies are subject to Companies Act 2006 rules on conflicts, plus any additional supplementary provisions in their articles).
14. The one drawback may be that SCIOs are relatively new and unfamiliar corporate bodies. It is our view, however, that there have been sufficient numbers of SCIOs registered since they became available on 1 April 2011 to pave the way for others to engage with funders, public and private sector partners and investors with the comfort that the SCIO structure has proved to be robust, and has been specifically developed for the Scottish charity sector. We have incorporated a number of SCIOs for clients and have yet to experience any particular difficulties with funders and other stakeholders.
15. Once the SCIO has been incorporated, it is likely to be a less time-consuming model to sustain than a company limited by guarantee, as it does not have to comply with company law annual accounting requirements and management of its public record.