

SETTING UP A CHARITY

This Fact Sheet, which is one of a series we provide to assist Charities, is aimed at anyone or any Steering Group which is contemplating setting up a Charity.

Introduction

Every year, hundreds of groups set up as charities in Scotland. They encompass all sorts of interests and activities - environmental issues, medical concerns, working with the young, the elderly, ethnic minorities and so on. However, gaining charitable status is a formal process with implications to be considered carefully.

The following notes are intended for initial guidance only to those who wish to set up formally a new non-profit-distributing organisation, which may or may not also be recognised as a Scottish charity. Detailed advice and assistance should be sought at the earliest stage as, increasingly these days, an "off-the-shelf" solution is not usually appropriate.

The full text of **The Charities and Trustee Investment (Scotland) Act 2005** is online at www.opsi.gov.uk/legislation/scotland/acts2005/20050010.htm The Office of the Scottish Charities Regulator ("OSCR") has been established - and its website is at www.oscr.org.uk with news, guidance and a list of relevant publications, as well as the new Scottish Charity Index ("The List").

Whilst the Act contains many new, significant and important features, for the most part it continues the pre-existing charitable process, with a number of changes of emphasis and some of detail, but without radical upheaval. We provide detailed advice in this respect on a case-by-case basis and please also see our Fact Sheet '[A Quick Guide to the Act](#)'.

Legal Structure

A new charity can be:

- an unincorporated association (or membership club)
- a trust formed by a Deed of Trust (usually granted by one or more individuals)
- a company limited by guarantee, but without a share capital (known commonly as a "guarantee company")

- a Scottish Charitable Incorporated Organisation (a “SCIO”).

There are other models, but these are the most common. Most non-profit-distributing organisations nowadays opt to become guarantee companies or SCIOs, because of the limited liability afforded to members and Trustees.

Please see our separate Fact Sheets [‘What is a Guarantee Company?’](#) and [‘What is a SCIO?’](#) Our experience is that most charities require a tailor-made solution, along the lines we have been providing for many years. As part this service, we can advice on the type of organisation most fitting to your proposals.

In addition a Community Interest Company was introduced in the Companies (Audit, Investigations and Community Enterprise) Act 2004. It is intended to be used by social enterprise organisations which are *not* charities, but which are non-profit-distributing, provide a benefit to the community and may be able to provide a limited return to ‘investors’.

What is a Charity?

A charity is an organisation which has been established exclusively for charitable purposes. Its main features are as follows:

- its name is not one which OSCR could consider to be objectionable;
- all of its purposes (its aims and objectives) are exclusively charitable;
- its activities provide Public Benefit;
- any conditions on obtaining Public Benefit are not unduly restrictive;
- its income (and any other resources) must be applied only to its Charitable Purposes;
- the people involved in its policy decisions (the members of its management committee, or its trustees, or its directors - depending on the type of legal structure) should not (normally) be paid employees of the charity;
- if the legal structure involves a membership, there must be a clause in the constitution prohibiting the payment of dividends, profits or other returns to members; and
- if and when the charity comes to an end, for whatever reason, its surplus assets have to be given to another charity or charities.

Section 7 of the Charities and Trustee Investment (Scotland) Act 2005 provides the definitive list of sixteen Charitable Purposes (in older constitutions, these would be known as “the Objects”) and the charity’s activities must fall exclusively within one or more of these categories, which are:

- (a) the prevention or relief of poverty,
- (b) the advancement of education,
- (c) the advancement of religion,
- (d) the advancement of health,
- (e) the saving of lives
- (f) the advancement of citizenship or community development,
- (g) the advancement of the arts, heritage, culture or science,
- (h) the advancement of public participation in sport,
- (i) the provision of recreational facilities, or the organisation of recreational facilities, with the object of improving the conditions of life for the persons for whom the facilities or activities are primarily intended,
- (j) the advancement of human rights, conflict resolution or reconciliation,
- (k) the promotion of religious or racial harmony,

- (l) the promotion of equality and diversity,
- (m) the advancement of environmental protection or improvement,
- (n) the relief of those in need by reason of age, ill-health, disability, financial hardship or other disadvantage,
- (o) the advancement of animal welfare,
- (p) any other purpose that may reasonably be regarded as analogous to any of the preceding purposes.

In addition to complying with one or more of these Charitable Purposes, the charity must ensure that its activities provide Public Benefit. The provision of Public Benefit denotes at least some activity, so an inactive or dormant charity might not pass the 'Public Benefit' test.

Thus the charity will, on an ongoing basis, have to demonstrate that it provides public benefit. In assessing public benefit, the Act states that regard must be had to how any–

- (a) benefit gained or likely to be gained by members of the charity or any other persons (other than as members of the public), and disbenefit incurred or likely to be incurred by the public, in consequence of the charity's exercising its functions, compares with the benefit gained or likely to be gained by the public in that consequence, and
- (b) where benefit is, or is likely to be, provided to a section of the public only, whether any condition on obtaining that benefit is unduly restrictive (including any charge or fee).

The charity's work must be intended to benefit the general public or a reasonably large section of the general public. This test would exclude, for example, clubs which are run for the benefit of their members, or a project involving the renovation of a listed building if the public were to be denied access. It also has implications in relation to training (a training course will not be considered as charitable if it is open only to employees of a specific organisation) and research (research will not be charitable unless the results are to be made public).

Charitable Status - or not ?

If a body is unlikely to benefit financially from the tax privileges available to charities and if there is no intention to seek funding from sources which can only give to charities, it may not be worthwhile applying for recognition as a charity. Also, if proposed activities are mainly intended to benefit a specific membership or if all the decision-making is to be carried out by people who draw a wage from the project, then this would be incompatible with charitable status. The Steering Group should discuss with its legal adviser how important the benefits would be in particular circumstances and whether the proposed aims would be compromised unacceptably by the restraints of being a charity.

Some would-be charities may be hesitant about taking on all of the responsibilities and liabilities inherent in the Charities and Trustee Investment (Scotland) Act 2005, whilst others may be set up for a specific purpose (such as to register a community interest in land under the Land Reform (Scotland) Act 2003, but then do nothing for some time (perhaps, continuing the same example, unless or until the landowner gives the community body an opportunity to proceed with an actual purchase of the registered land). In such cases, where promoters are unsure or where there may initially be a period of inactivity or dormancy, it may be better to make sure that the new organisation is "charity-enabled", that is, compliant with the Act and able to apply to

OSCR at any time in the future to be registered formally as a charity, but deliberately choosing not to do so unless the right situation arises for it to be appropriate to do so.

Advantages of being a charity

1. Donations can be received from individuals and companies through annual covenants, deposited covenants, Gift Aid or payroll giving, with relative Income Tax and Inheritance Tax advantages.
2. Donations can be received from other charities.
3. Exemption is given from Income Tax (s. 505 of the Income and Corporation Taxes Act 1988), Capital Gains Tax (s.256 and 257 of the Taxation of Capital Gains Act 1992), some Value Added Tax (especially on the sale of donated goods in charity shops), Corporation Tax and (where public trusts would otherwise be subject to tax as being discretionary) Inheritance Tax.
4. Relief is available from local authority Rates. 80% relief is standard, on application. In the past, this was usually brought up to 100% by discretionary relief, but this is now less likely because of Local Authority funding constraints. Whatever, the sewerage rate is still charged.
5. Public image.

Disadvantages of being a charity

1. Adherence to accounting requirements in terms of the Accounting Regulations and Statements of Recommended Practice.
2. Adherence exclusively to the stated and approved Charitable Purposes and demonstrating that its activities provide Public Benefit..
3. No return is permitted to members (they cannot be 'investors' and cannot partake in profits or dividends).
4. A duty to provide information on request to OSCR.
6. A duty to provide members of the public on request with a copy of the charity's constitution and its last statement of accounts.
7. Compliance with the Charities and Trustee Investment (Scotland) Act 2005 and supervision and potential investigation thereunder by OSCR.
8. The need to create a separate trading subsidiary, if there is to be any non-charitable work, with additional costs involved.

If it is considered preferable to seek charitable status, the constitution of the association, trust deed of the trust or Memorandum & Articles of Association of the Guarantee Company would require to be approved by OSCR before being registered formally as a Scottish charity.

Community Amateur Sports Clubs

Prior to the Charities and Trustee Investment (Scotland) Act 2005, it was possible for Community Amateur Sports Clubs (CASCs) to obtain many of the advantages of charitable status, without being a charity.

Although charitable status has been conferred upon organisations which promote public participation in sport, it is likely that a number of existing CASCs will seek to remain as CASCs and that others may seek to become CASCs instead, either to avoid the obligations of the Act, or because it may be difficult to comply without the Public Benefit test. The Act specifically preserves CASCs and, indeed, ensures that they, like charities, are also entitled to 80% relief from Local Authority Rates.

A CASC must:

- (a) be of an amateur nature;
- (b) be open to all members of the public;
- (c) be non-profit distributing; and
- (d) provide facilities for one or more sports; but
- (e) provide only the normal facilities of an amateur sports club to its members.

CASCs are not charities but enjoy all the tax benefits of one (including Gift Aid).

Non-Charitable Trading

It is essential that all of a charity's funds are used for its stated Charitable Purposes only: - this is an absolute rule. In this connection it is helpful to ask three essential questions:

1. what are the charity's Charitable Purposes?
2. is the proposed course of action going to further its Charitable Purposes?
3. is the proposed course of action in the best interests of the charity and its Charitable Purposes?

Whenever a charity wishes to conduct activities outwith its Charitable Purposes ("non-charitable trading"), it will be necessary to create a separate trading subsidiary. The question of trading needs to be considered more and more carefully, as charities are forced to look at other ways to boost their income. If a charity trades non-charitably, it risks not only the taxation of its profits (by virtue of s.832 of the Income & Corporation Taxes Act 1988), but also the loss of its charitable status.

Thus, for example, where a charity runs a theatre, its drama is charitable (cultural education), but feeding its audience before or after a dramatic performance is not. That charity would have to set up a separate trading subsidiary to run the catering operations.

Where a trading subsidiary exists, it will arrange to covenant its surplus profits to the charity. However, care must be taken in setting up a trading company and particularly in working out for what each of the charity and the trading company is responsible.

It is essential to work out the process carefully because there funds go up a One Way Street - the trading subsidiary can send funds to the charity, but the charity cannot send funds back to the trading subsidiary.

In the example of the theatre, one would need to work out if it makes sense for the catering equipment to be owned by the charity and leased to the trading subsidiary or whether it be both purchased and owned by the trading subsidiary.

Careful planning is therefore required and expert advice from the charity's lawyers and accountants is essential.

Although carefully prepared, this Fact Sheet is a guide only and is not intended to be comprehensive. Specific advice should be requested on individual situations.

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Accredited by the Law Society of Scotland as a specialist in Charity Law

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2015 edition