

Establishing a grant-making organisation in the UK

AN INTRODUCTORY GUIDE

By Sarah Chiappini of Filanthropia Consulting

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Introduction

1. This note sets out some basic considerations and options in relation to setting up a grant-making organisation in the UK. Some such organisations are referred to as “Foundations” (which is a term commonly adopted in the United States). However, in English law the term “Foundation” is not a defined term. Some grant-making organisations are established as charities and some as not for profit organisations.
2. The following are some of the key questions that I am typically asked by those considering establishing a grant-making organisation:-
 - a. Does the organisation have to be a charity?
 - b. If not, what are the alternatives?
 - c. What is the tax position regarding the various options?
 - d. What are the governance/regulatory requirements?
 - e. Could the organisation accept donations from donors outside the UK and would that be tax effective?
3. I have addressed these queries below (although not necessarily using the same wording or in the same order).

Establishing and operating as a charitable grant-maker

4. There are significant benefits in operating as a charity. However, in return for those benefits charities must operate within the confines of charity law and they are registered with and regulated by the Charity Commission for England and Wales (“the Charity Commission”).
5. In the section below I have set out the benefits of operating as a grant-making charity, together with the resultant legal and regulatory requirements. Following that section (from page 6 onwards) I then cover potential alternatives: utilisation of donor advised funds and establishing a not for profit company limited by guarantee or a Community Interest Company (also known as CICs).

Benefits of operating as a grant-making charity

6. As well as the kudos and the often increased access to funding arising from being a charity, there are also significant tax benefits for the charity itself and for donors. These are summarised below.

Gift aid

7. Individual UK tax payers and UK registered companies could donate to the charity via the gift aid scheme.
8. Based on the tax rates as at the date of this note, the charity could claim back from HM Revenue and Customs (“HMRC”) 25 pence in every one pound donated by individual UK basic tax payers.
9. Higher rate individual UK tax payers could claim tax benefits via their annual tax return.
10. Donations made by UK companies are treated as allowable expenses for the purposes of corporation tax.

Other tax reliefs

11. The charity would not be liable to income tax, corporation tax or capital gains tax.
12. Donations to the charity via legacies would be exempt from inheritance tax.

Practicalities of operating as a grant-making charity

13. Unsurprisingly, the tax benefits afforded to charities bring with them legal and regulatory requirements.

Charity law

14. The charity would need to operate within the confines of charity law. The activities of the charity must be exclusively charitable as recognised in English law in that they must fall within specified charitable purposes and carried out for the benefit of the public. There are also strict rules regarding:-
- the payment of charity trustees (see also paragraph 17 below);
 - managing conflicts of interest; and
 - operating independently of other organisations.

Charity Commission

15. As mentioned above, the charity would be registered with and regulated by the Charity Commission. The trustees would need to report to the Charity Commission on an annual basis. There are different filing regimes which depend on the level of a charity's income and how a charity is constituted. The Charity Commission does not charge registration or filing fees.

HMRC

16. In order to receive donations via gift aid (see paragraphs 7 to 10 above) the charity must also register with HMRC.

Trustees

17. The charity would need a minimum of three trustees, the majority of whom must be resident in England or Wales. Trustees and anyone connected to them (eg family members or business partners) cannot receive a personal benefit from the charity save only in very limited circumstances. For example, a trustee would not be able to be an employee of the charity without prior authority from the Charity Commission. Trustees could, however, be paid for services provided to the charity (ie on a contractual basis), subject to certain conditions being met and procedures being followed.

18. The trustees of the charity would be ultimately and collectively responsible for the management and control of the administration of the charity. They would have various legal duties and responsibilities: the key duties and responsibilities are summarised below:-

- *Ensure that your charity is carrying out its purposes for the public benefit*
- *Comply with your charity's governing document and the law*
- *Act in your charity's best interests*
- *Manage your charity's resources responsibly (also known as the duty of prudence)*
- *Act with reasonable care and skill (also known as the duty of care)*
- *Ensure your charity is accountable*

Please see the Charity Commission's guidance CC3 for further details (link below):

<https://www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3>

19. Each trustee would need to complete a Charity Commission trustee eligibility declaration and an HMRC fit and proper persons declaration (see the links below):

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/960027/Trustee_Declaration_Form_Fields_December_2020.pdf

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/597664/Fit-and-proper-persons-helpsheet-and-declaration.pdf

Employees

20. The charity would not need to have any employees. However, if the charity were to have employees the trustees would need to ensure that:-

- employing someone for the role in question was necessary in all the circumstances;
- each person employed was the best person for the job (preferably by advertising the position on the open market); and
- the salaries paid were reasonable and appropriate for a charity of that type and size – in other words the salaries are benchmarked.

21. The charity would need to declare in its annual accounts all salaries of £60,000 and over.

What legal form would the charity take?

22. Historically most grant-making charities were established as either charitable trusts or, more latterly, as charitable companies limited by guarantee. However, in recent years a specific corporate legal structure for charities has been introduced: the charitable incorporated organisation (“CIO”). It will be necessary to adopt one of the model governing documents for CIOs produced by the Charity Commission: either the “Foundation model constitution” or the “Association model constitution”: the latter would be appropriate only if there was to be a wider (or voting) membership, which would be unusual for a grant-making charity.

23. Generally I would advise that the corporate CIO (Foundation model) structure were adopted. A CIO has its own legal personality which means that it can hold assets (such as land and investments) and enter into contracts in its corporate name. The advantages of the CIO model are that:-

- there would be no need to transfer title to charity property or novate or assign contracts each time a trustee retires or is appointed;
- it would be the charity (ie the CIO), rather than the individual trustees, who can sue and be sued; and
- the trustees would have limited liability in that they will not, subject to certain exceptions, be personally liable for the debts of the charity, even if there are insufficient funds to honour such debts. (The exceptions to limited liability include, for example losses incurred by a charity as a result of a breach of trust/duty; non payment of PAYE and National Insurance contributions; wrongful trading situations; and payments made to a trustee when he/she is not legally qualified to act as a trustee).

Donations from tax payers in other jurisdictions (also known as cross boarder donations)

24. If non-UK tax payers wanted to make donations to the UK charity, in order to be tax effective so far as the donors are concerned the donations would generally need to be made via:-

- a recognised charitable or not for profit organisation in the country in which the donor is tax resident (eg via a US 501(c)(3) for US tax payers); or
- an organisation that runs donor advised funds established outside the UK and/or operates/works with an international network of recognised charities or not for profit organisations for the purpose of facilitating cross-border donations – for example the Charities Aid Foundation, Chapel & York, Prism the Gift Fund and Transnational Giving Europe (links below). There will of course be fees charged for handling the donations and you should be able to download these from the relevant websites.

<https://www.cafonline.org/international-giving>

<https://chapel-york.com/>

<https://prismthegiftfund.co.uk/>

<https://www.transnationalgiving.eu/>

25. Please note that the examples of the various organisations referred to above that could assist with the receipt of international donations is not exhaustive: they are given for illustrative purposes only.

Alternatives to establishing a grant-making charity

26. These include:

- Use of donor advised funds
- Establishing a not for profit company limited by guarantee; and
- Establishing a Community Interest Company (“CIC”).

Donor advised funds

27. Rather than establish a separate charity, tax effective charitable giving for UK tax payers can be made via donor advised funds established in the UK such as those operated by CAF, Chapel & York and Prism the Gift Fund - see paragraph 24 above for website links.

28. As with a separately registered charity, donations from donor advised funds can be made on a national and international basis provided that the funds are given and applied for purposes that are charitable in English law.

Not for profit company limited by guarantee

29. This structure would be appropriate where the proposed activities of the new organisation are not exclusively charitable (or not charitable at all). As its name suggests, any surplus income would be ploughed back into company: there would be no profit distribution.

Benefits of a not for profit company over the charitable model

30. The benefits of operating as a not for profit company are:-

- they are not subject to charity law restrictions and can therefore undertake a wide variety of activities;
- the directors will have limited liability (subject to certain exceptions similar to those for CIOs as referred to at paragraph 23 above, for example, where they are in breach of their fiduciary duties as directors¹; in relation to non payment of PAYE and National Insurance contributions; and wrongful trading situations);
- they are regulated by Companies House rather than the Charity Commission: the former being a relatively “light touch” regulator;
- they have flexibility regarding the number of directors but, as with charities, three is generally recommended as good practice; and
- there is more flexibility regarding payment of directors.

¹ The fiduciary duties of directors are summarised in the appendix to this note.

Disadvantages

31. The disadvantages of operating as not for profit company are:-

- they generally have less kudos than being a charity and sometimes it is more difficult to obtain funding; and
- there are no tax benefits for both donors and the company itself. The company will be charged corporation tax on any surplus income. However, with careful planning regarding the timing of income streams and resultant expenditure, the company may be able to operate on an almost break even basis thus minimising corporation tax payable.

CICs

32. These are a specific type of not for profit company. They are subject to more regulation than not for profit companies limited by guarantee.

Key features

33. The specific features of a CIC are:-

- they are subject to specific company law provisions;
- they must be established for the benefit of the community (eg they cannot be political);
- their governing document (articles of association) must take a prescribed form;
- they must register with the CIC regulator (via Companies House) and file an annual report and accounts with the CIC regulator;
- unlike charities, CICs can have provisions in their articles of association whereby up to 35% of surplus income can be distributed to individual or institutional shareholders;
- with the exception of the 35% income distribution limit referred to at e. above, CICs are subject to an entrenched asset lock imposed

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by law which means that it would not be possible to amend the articles of association so that the CIC is no longer a not for profit company. (There is no such entrenched asset lock for a standard not for profit company, but in practice funding contracts and the like would often prevent such a company switching from operating on a not for profit basis).

Benefits of CICs over the charitable model

34. These are essentially the same as those relating to the company limited by guarantee model as summarised at paragraph 30 above, save that CICs are subject to more restrictions regarding the activities they can undertake.

Disadvantages

35. These are essentially the same as those relating to the company limited by guarantee model as summarised at paragraph 31 above but see also paragraphs 36 and 37 below.
36. In addition, although CICs possibly have more kudos and might, in some circumstances, more readily attract funding over the not for profit limited by guarantee model they are subject to more regulation than not for profit companies.
37. Generally, therefore, I would recommend the not for profit company by limited by guarantee model instead of a CIC unless you are trying to attract external investors or where, for example, the organisation will be involved in a project (ie a regeneration project) which requires funding from local government.

I hope this note is helpful and please do contact me should you require further advice or assistance.

Please note that this document provides a general summary only and it does not constitute legal advice. It is recommended that specific advice is sought in relation to the particular facts of a given situation.

Sarah Chiappini
Director and solicitor
Filanthropia Consulting

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Filanthropia Consulting Limited, Heath House, Alldens Lane, Godalming, Surrey GU8 4AP
Tel: 01483 427 441 email: sarah@filanthropia.co.uk www.filanthropia.co.uk

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General fiduciary duties of company directors

The general fiduciary duties of company directors are:

- *Duty to act in accordance with the powers set out in the company's constitution (ie the articles of association);*
- *Duty to promote the success of the company for the benefit of its members (which in practice will be for the benefit of the declared purposes of the company);*
- *Duty to exercise independent judgment;*
- *Duty to exercise reasonable care, skill and diligence;*
- *Duty to avoid conflicts of interest;*
- *Duty not to accept benefits from third parties;*
- *Duty to declare to the company's other directors any interest a director has in an existing or proposed transaction or arrangement with the company.*