

Incorporation and Big Local

The duties and liabilities of charity trustees and company directors

Introduction

This guidance is for those involved in a Big Local partnership that is thinking about becoming an incorporated organisation or setting up a separate legal body. This guidance is designed to help you to understand further the duties and liabilities of charity trustees and company directors but should not be used as a replacement for seeking professional advice or consulting other guidance from the government or regulators.

Where you may be appointed as either a charity trustee or a company director (or both, depending on the legal body which is set up), this guidance summarises your duties and the rare situations where personal liability can arise.

It should be read alongside the 'Incorporation and Big Local' guidance documents [‘setting up a new legal body’](#) and [‘Big Local partnerships becoming their own locally trusted organisation’](#).

There is a glossary at the end of the guidance which explains the meaning of the more technical legal terms written here.

Different Legal Forms

The guidance ‘Setting up a new legal body’ sets out various types of legal body which may be suitable for your Big Local partnership becoming an incorporated organisation or setting up a separate legal body. Depending on the type of legal body, you may have responsibilities as company directors and/or charity trustees. The table below confirms what your status will be, depending on the legal body being used:

Name of legal body	Description	Acronym	Company Director?	Charity Trustee?
Charitable company limited by guarantee	A registered charity and company	CLG	Yes	Yes
Charitable incorporated organisation	A registered charity	CIO	No	Yes

Community interest company	A non-charitable company	CIC	Yes	No
Charitable Community benefit society	A charity, currently exempt from registration with the Charity Commission	CBS (also sometimes known as a Bencom)	No	Yes

A lot of the duties described in this note represent the 'common sense principles' of good governance so even when a different type of legal body is used where you are not a company director or, alternatively, not a charity trustee, you will still be expected to conduct the affairs of the legal body along these lines. For instance, a CIO is not subject to all the statutory obligations of companies (although some apply to them), but as they are charities, many of the duties of charity trustees overlap with those of company directors. Similarly, CBSs also have statutory obligations which are equivalent to those of companies.

The CIC is slightly different from the other options because a director of a CIC will not have the duties of a charity trustee. Duties relating to governing a charity would not apply to a CIC although you would still be aiming to benefit the community through the pursuit of a social purpose alongside potential social enterprise activities. In addition, as long as you are receiving charitable funds for your Big Local project, you will be acting in a fiduciary capacity in relation to this money and the funds would need to be used in furtherance of the charitable aims they were given for, in line with the Big Local plan. To this end, the directors would need to be aware of the duties of charity trustees to the extent that they relate to the good management and use of charitable funds.

Duties of Company Directors

This section directly applies to directors of CLGs and CICs but is relevant to CIOs and CBSs as principles of good governance or under equivalent statutory provisions for these legal bodies.

The directors are responsible for the management and operation of the company or charity. They should each take an active role in the running of the company or charity and all directors are bound by the decisions of the Board. The directors are individually and collectively responsible for decisions taken by the Board.

As company directors, you have the following duties under the Companies Act 2006:

- (a) **Duty to act within powers:** you must act in accordance with the governing document (usually articles of association) and only exercise your powers for the purposes for which they are given.
- (b) **Duty to promote the success of the company:** you must act in a way that you consider, in good faith, would be most likely to promote the success of

the company. In the case of a charitable company, this would include furthering the charity's objects.

- (c) **Duty to exercise independent judgment:** this means that you must not, for example, agree to act at the direction of a third party to exercise your decision-making powers in a particular way.
- (d) **Duty to exercise reasonable care, skill and diligence:** this means the care, skill and diligence that would be exercised by a reasonably diligent person with:
 - (i) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 - (ii) the general knowledge, skill and experience that the director has.

This duty requires appropriate engagement from each of the directors in the running of the company and the business to be considered and voted upon by the Board.

Where a director has specialist knowledge in relation to the subject matter of the decision, a higher standard must be met. This means that, for example, a director with a legal or investment background will be held to a higher standard in respect of those areas than a person without that specialised knowledge.

- (e) **Duty to avoid conflicts of interest and the duty to declare an interest in a proposed transaction or arrangement:** you must avoid a situation in which you have, or could have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. A conflict of interest includes a conflict of loyalty. This duty is not breached if:
 - (i) a situation cannot reasonably be regarded as likely to give rise to a conflict of interest/loyalty; or
 - (ii) the matter has been authorised by the directors not affected by the conflict.

Separately, if you are, in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, you must declare the nature and extent of that interest to the other directors. (An example would be if the company you are a director for was commissioning a piece of work and a business owned by your family member was going to apply to deliver the piece of work.)

- (f) **Duty not to accept benefits from third parties:** you must not accept a benefit from a third party given by reason of being a director or you doing (or not doing) anything as director.

These duties overlap to some extent with the duties of charity trustees described below as both charity trustees and company directors are fiduciaries.

Trustees' Duties

This section applies to CLGs, CIOs and CBSs only (although these duties overlap with the duties of company directors).

A charity trustee's legal duties come from the charity's governing document and a mixture of charity and trust law. The Charity Commission has produced a helpful summary in its guidance, [the Essential Trustee¹](#), which deals with the overlapping duties from various areas of law. This is a summary of the key duties which a trustee has:

- (g) **Ensuring that the charity is carrying out its purposes for the public benefit.** This includes reviewing the charity's activities and understanding how the public benefit from the charity. It is a breach of duty (often called a breach of trust in a charity context) to undertake any activities outside the charity's purposes, and you could be held liable to repay to the charity any moneys spent on activities outside the purposes.
- (h) **Complying with the charity's governing document and the law.** The trustees are collectively responsible for ensuring that the charity complies with the law generally and with charity law and regulatory requirements (examples include data protection and health and safety law).
- (i) **Acting in the charity's best interests.** This includes making balanced and informed decisions. You are expected to act in good faith and honestly in the best interests of the charity at all times. Avoiding conflicts of interest or loyalty is a key part of acting in the charity's best interests. The general rule is that trustees may not get personal benefits from their positions. For example, unless so authorised in the articles of association or by the Charity Commission, a trustee cannot be paid for acting as trustee. (Trustees can, in certain scenarios and within set parameters, receive payment for providing goods or services to their charity).
- (j) **Managing the charity's resources responsibly.** This includes avoiding exposing the charity's assets, beneficiaries or reputation to undue risk and complying with any restrictions on spending funds or selling land. In particular, you have a duty to protect all of the assets belonging to the charity, for instance by ensuring that there are adequate financial controls in place and the charity's assets are secure, maintained and insured (if relevant).
- (k) **Acting with reasonable care and skill.** You must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with the general knowledge, skill and experience that he or she has. This means that a trustee with a legal or investment background will be held to a higher standard in respect of those areas than a person without that specialised knowledge.
- (l) **Ensuring the charity is accountable.** This includes demonstrating that the charity is well run and is effective, complying with accounting and reporting requirements and ensuring accountability where decisions are delegated.

¹ <https://www.gov.uk/government/publications/the-essential-trustee-what-you-need-to-know-cc3>

Liability – Liability to Third Parties

This section applies to both charitable and non-charitable legal bodies

All the legal bodies enjoy the benefit of a legal personality and limited liability. This means they can operate and contract with third parties in their own names. In the case of a claim against them, e.g. for breach of contract, it would be the assets of the legal body which would be available to meet its liabilities and no claimant could have recourse to the personal assets of the directors/trustees.

There are only limited circumstances where a director or a charity trustee may be personally liable, principally for 'fraudulent' or 'wrongful' trading and corporate manslaughter (the unusual situation where the company's activities are managed or organised to cause a person's death).

Liability - Breach of Trust

This section applies to both charitable and non-charitable legal bodies

Despite the corporate form of the legal bodies described in this guidance note, a director and/or trustee can be held personally liable if they have been negligent in discharging their duties or are otherwise in 'breach of trust'. Examples include acting outside their powers, and, in the case of a charity, misapplying the charity's assets to a non-charitable purpose, or failing to manage the company's affairs properly, leading to an unnecessary payment of tax. Provided directors/trustees remain mindful of their duties and powers when making decisions (taking advice as may be needed), they can manage the risk of accidental breach of trust.

The consequences of a breach of trust might include being removed as a director/trustee and being pursued for the amount of any financial loss to the legal body that resulted from the breach.

It may also be a comfort to know that, in the case of the charities, the Charity Commission has the power to decide not to suspend a trustee and set aside breaches of trust where the trustee acted in good faith and it would not be in the interests of the charity to enforce the breach. Therefore, it is relatively rare for trustees to be held personally liable to their charity for accidental actions or oversights.

Insurance

This section applies to both charitable and non-charitable companies.

If there is particular concern in relation to personal liability, it is possible for the company to take out Directors and Officers Insurance or Trustee Indemnity Insurance.

Please note that certain liabilities would not be covered by insurance. This includes:

- (m) fines imposed in criminal proceedings or by regulatory authorities for non-compliance with a regulatory requirement.
- (n) any liability incurred in defending against criminal proceedings if the director/trustee is then convicted of an offence arising out of any fraud or dishonesty, or willful or reckless misconduct; or

- (o) any liability to the legal body that arises out of conduct which the director/trustee knew (or reasonably should have known) was not in the best interests of the legal body.

Without Directors and Officers Insurance or Trustee Indemnity Insurance you are, in any event, usually entitled to be refunded out of the assets of the legal body for any liabilities incurred by you as a director/trustee (other than the exceptions above). However, insurance can be helpful because it makes sure that you are refunded even if there are insufficient assets in the legal body to cover the liability.

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Glossary

Duty – something that the law obliges you to do or refrain from doing.

Equivalent statutory provisions – relevant laws found in other statutes.

Fiduciary capacity – taking on the role of a fiduciary – see below.

Fiduciary – someone considered by the law to be in a position of trust who, for example, has a responsibility to look after property (e.g. charitable funds) on behalf of somebody else (e.g. the people who benefit from a charity) and not use this property for his or her own personal benefit.

Legal personality – the law treats the particular legal body as though it is a person in its own right, which can, for example, enter into contracts in its own name rather than the names of its individual trustees.

Liability – a legal responsibility for, for example, financial losses, breaches of contract, injuries on organisational property or offences committed by employees.

Limited liability – provides a layer of protection for legal bodies and means that, apart from in exceptional circumstances, a creditor can only take assets or finances belonging to the company and cannot touch the assets or finances of the directors/trustees personally.

Personal liability – the rare situations where you, rather than the charity, are held responsible for a particular act (e.g. a dishonest act resulting in loss to the charity or somebody else) and as a result, any money that is owed because of that act (e.g. damages or a fine) would have to be paid by you out of your own personal finances.

Regulatory requirements – anything demanded by a regulator, e.g. the Charity Commission is the regulator of charities.

Statute – an Act of Parliament that sets out the law in written form (e.g. the Companies Act 2006 sets out laws relating to companies).

Statutory obligation – a legal obligation to do something or refrain from doing something in accordance with the law as written in a statute.

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This document will be developed over time with input from the people using this material. If you have thoughts on how this document can be made more useful for you, particularly if you live in one of the Big Local areas, please let us know.

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If you need this document in other formats or a community language please get in touch with Local Trust and we will help you.

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