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Keeping it legal

a guide to legal
forms for social
enterprises

The Social Enterprise Coalition

The Social Enterprise Coalition is an alliance of social enterprises from across the UK. It is the voice of social enterprise bringing together all types of social enterprises through its membership.

The Social Enterprise Coalition works to influence the fast-moving social enterprise agenda by:

- Building capacity and quality through information sharing
- Encouraging co-operation
- Promoting the social enterprise sector
- Providing a strong voice for the sector

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Bates, Wells and Braithwaite

Bates, Wells and Braithwaite is widely regarded as one of the leading social enterprise law firms in the country and is passionate about working with and for the sector. We act for a large number of social enterprises, from national and international organisations to start-ups. We can advise and assist on:

- Legal forms, including joint working and partnership arrangements
- Finance arrangements
- Intellectual property
- Property
- Employment
- Immigration
- Dispute resolution

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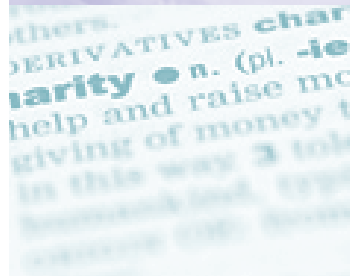
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what is this guide? for

Choosing a legal form is an important part of establishing a social enterprise, which should rank equally with finding finance, developing a business plan and finding the right staff. Your legal form provides the framework for your business, and it is important to set the rules correctly in order to make it as easy as possible for your social enterprise to be successful.

This guide to social enterprise structures and legal forms is designed to take you through some of the main issues you need to consider when setting the rules and regulations that govern your business.

It starts by outlining some of the things to consider when setting up a new organisation or operation. It will then take you on to questions about how to develop the organisational model through which your business will operate, including questions about how to involve the various stakeholder groups in the enterprise, whether you should set up as one organisation or as a ‘family group’ of organisations, and how you should control the business.

Finally, it will go through all the possible legal forms that your business could use, briefly describing each and giving you information to decide whether they are appropriate for your business.

This guide is designed for the information of readers. Whilst every effort has been made to ensure accuracy at the time it was written, information contained in this guide may not be comprehensive and may become out of date.

Readers should not act upon the information contained in this guide without seeking professional advice. We cannot accept any liability for actions arising from the use of the information in this guide.

A glossary is provided in the back of this guide to explain some of the more complicated terms. Further resources, including full case studies, can be found on the Social Enterprise Coalition website:
www.socialenterprise.org.uk/legal.

What is a social enterprise?

Social enterprises are businesses that trade in the market with a social purpose. A social enterprise is not defined by its legal status but by its nature: its social aims and outcomes; the basis on which its social mission is embedded in its structure and governance; and the way it uses the profits it generates through trading activities. Social enterprises share a number of common characteristics:

- 1** Enterprise orientation—they are directly involved in producing goods or providing services to a market;
- 2** They have explicit social aims such as job creation, training or the provision of local services. Their ethical values may include a commitment to building skills in local communities. Their profits are principally reinvested to achieve their social objectives;
- 3** Social ownership—many social enterprises are also characterised by their social ownership. They are autonomous organisations whose governance and ownership structures are normally based on participation by

stakeholder groups (eg. employees, users, clients, local community groups and social investors) or by trustees or directors who control the enterprise on behalf of a wider group of stakeholders. They are accountable to their stakeholders and the wider community for their social, environmental and economic impact. Profits can be distributed as profit-sharing to stakeholders or used to the benefit of the community.

The UK Government defines social enterprises as: *‘Businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.’*

For more information, visit:
www.dti.gov.uk/socialenterprise

For more information on the social enterprise sector you can visit the Social Enterprise Coalition’s website and in particular, see *There’s more to business than you think: a guide to social enterprise*, available on the website.

www.socialenterprise.org.uk

before setting up your social enterprise

Before setting up your social enterprise, you should consider the following factors, which may affect your choice of legal form.

In this section

- Safeguarding the social mission and allowing entrepreneurship
- Managing risk
- Financing
- Tax

Safeguarding the social mission and allowing entrepreneurship

Social enterprises are driven by their social mission. As a result, they will often seek to protect the social mission through their choice of legal form. However, the choice made must still allow the social enterprise the freedom to take advantage of any business opportunities that arise.

Regardless of the legal form adopted, some protections can be written into the social enterprise's constitution. However, without additional safeguards these can be amended at any time. By using particular legal forms you can take advantage of the additional intrinsic protections that they provide. See Chapter 4 for more detailed information on the different types of legal form.

social enterprises
are **driven** by their
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through their choice
of **legal form**

TREES

IPS community benefit society, set up as an 'ethical holding company'

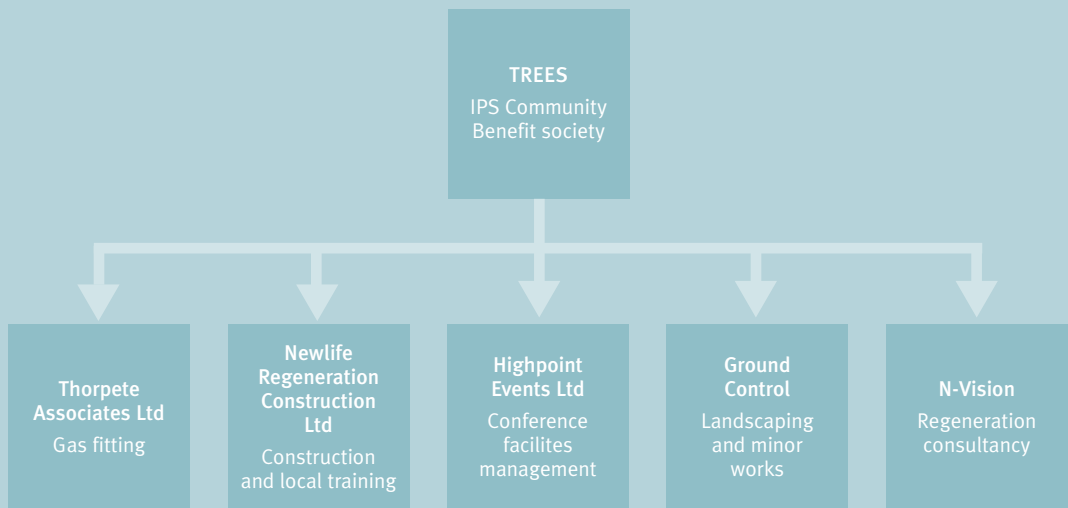


Business

TREES (Training Regeneration Education Employment Sustainability) is an 'ethical holding company', set up to be an engine of sustainable regeneration. It is the sole shareholder with a number of wholly-owned subsidiaries, which trade to support the social and environmental mission of TREES.

Safeguarding the social mission

TREES' constitution makes explicit its aims to support regeneration, which helps to focus the business activities of its subsidiaries. Any new business has to justify whether it fits with the core values of TREES as well as make a strong business case.



Contact: enquiries@lha-asra.org.uk

Website: www.lha.org.uk/social_enterprise.htm

The Big Life Group

CLG with separate charity, 'family' structure



Business

The Big Life Group creates chances for people to change their lives for the better. It works with people who have been excluded from mainstream society – due to discrimination, health, housing, education or skill. It provides a wide variety of opportunities and services, from employment to health services to childcare.

- The mission is also protected and embodied in the chief executive as the sole member, and the social entrepreneur who set up the organisation originally. There is a succession plan that allows the board to choose future members.

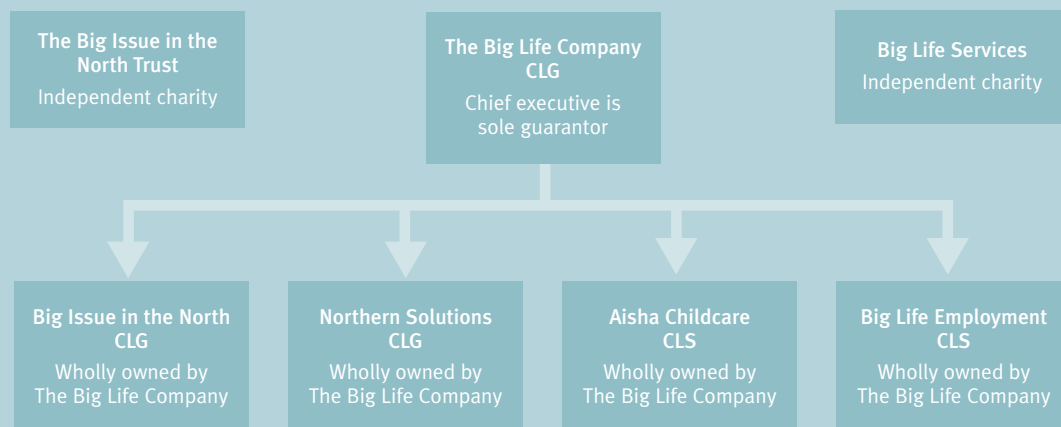
Safeguarding the social mission

- The Memorandum and Articles of Association stipulate the purpose of the organisation and protect the organisation's social mission.

See page 8 for more details on the CLG legal form.

Contact: info@thebiglifecompany.com

Website: www.thebiglifegroup.com



Managing risk

If your business is to be successful you will expect to take some business risks. However, all good business leaders seek to manage and minimise the risks they will take. Using an appropriate legal form is one way to do this.

One way to limit the risks that fall on the shoulders of individual directors is to incorporate your organisation. This makes the organisation itself a legal entity liable for its own obligations, thereby limiting the personal liability of individual management committee members, shareholders or members. Incorporation is an important consideration if the social enterprise intends to employ staff, take on significant property interests or undertake major contractual obligations or operational risks. Chapter 3 deals with incorporation in more detail.

Accessing finance

There are a range of sources of finance available to social enterprises, aside from the organisation generating its own surpluses to reinvest. Although some types of funding can be obtained by any legal form, other types are only available to certain legal forms.

Grants

Social enterprises often receive part of their funding through grants from charitable

foundations, government or European funds. Any legal form is able to accept a grant although charities tend to find funders more receptive.

Debt

Debt finance, usually in the form of loans, may be obtained from banks, specialist finance providers (such as community development finance institutions, CDFIs) or from supporters. Again, this source of finance is available to any legal form although an incorporated form is preferable as the obligation to repay the loan is a substantial liability.

Equity

Equity investment means a company ceding part-ownership and selling shares in itself to a third party in exchange for capital. Not all legal forms will allow a company to receive equity investment. See Chapter 4 for information on which legal forms will allow this.

The Financial Services and Markets Act 2000 (FSMA 2000) regulates the activities of businesses seeking to attract investors, in order to protect individuals without expert financial knowledge. It is always worth seeking expert legal advice before you think about undertaking any activity of this kind.

Tax

An obvious source of finance for any business is retention of profits. If your organisation is likely to be very dependent on its surpluses, perhaps because you are not able to access other forms of finance, then it is worth considering the tax implications of choosing certain legal forms. In particular, a wide variety of tax liabilities can be avoided or reduced through adopting charitable status. Chapter 5 deals with this in more detail.

For some social enterprises the mutuality principle is extremely important. This provides that where profits are derived from mutual trading between members of an organisation, those profits are not subject to tax.

It is worth considering
the **tax implications** of choosing
certain **legal forms**. A wide variety
of tax **liabilities** can be **avoided**
or **reduced** through adopting
charitable status.

Working out the organisational model

This section looks at different power structures to assist you in identifying the most appropriate governance structure for your organisation.

In this section

- An introduction to power structures
- Stakeholders
- Group or integrated structures

Having considered the factors outlined in Chapter 1, the next issue is governance. Who will be involved in the organisation, and how? Who should control it, and how far should their power extend? The answers to these questions will help you work out an appropriate governance structure, which should reflect how you wish the different groups involved to relate to each other. It will also help determine which legal form should be used and how it should be adapted to fit your particular circumstances.

Individuals and groups can also be involved in the organisation in ways that don't involve them actually controlling the social enterprise. Throughout this booklet we discuss ways of involving stakeholders (used in the broad sense to mean those individuals or groups with a vested interest in the organisation). Stakeholder involvement is a central feature of many social enterprises.

Stakeholders need first to be identified. Then the desirability of their involvement and the means by which they may become involved can be considered.

An introduction to power structures

The basis of most legal forms is a two-tier power structure whereby a small group of individuals are responsible for the day-to-day running of the organisation (called a board of directors, board of management, management committee, or board of trustees), but are

accountable to a wider group of individuals (often called members or shareholders).

This basic structure may be developed in a number of ways to suit the particular social enterprise, but the structures adopted by most social enterprises divide into four types:

Oligarchy

The individuals who make up the board are the same people as the members, and new appointments to the board are made by the board. When someone ceases to be on the board, they also cease to be a member of the organisation. This is a straightforward structure and is common to many social enterprises, in particular those that are new and still small.

Representative oligarchy

This is used by organisations which wish to have members who are organisations instead of individuals. For example, the members may be local authorities, charities, etc. Each member then appoints an individual to serve on the board.

Elected by membership

Here the membership group is wider than the individuals on the board and elects the board. This structure is often used by organisations which define themselves as co-operatives. The International Co-operative Alliance Statement on the Co-operative Identity describes a co-operative as ‘an autonomous association of

persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise’. There are many different legal forms that can be used to create an organisation which falls within this definition.

Appointed board

Here board members may or may not be members of the organisation, and are appointed to provide particular knowledge or skills to the board. Recruitment of board members in this way should be treated with the same care as recruitment of staff, and a number of organisations provide guidance on good practice.

See www.socialenterprise.org.uk/legal for more details.

Boards can also take a hybrid form, with for example a section of the board elected by the membership and further places available to co-opt appointed members with particular expertise.

Stakeholders

For some social enterprise managers and directors, some of the risks associated with running a business can be unfamiliar and daunting. For this reason you should think carefully about how you involve different groups in the running of the business, ensuring that individuals who have responsibility for the

business have the appropriate experience or support to cope with the decisions they have to make. Here we will go into more detail about stakeholder involvement, in order to help you work out a governance structure for your organisation that takes these issues into account.

ADVANTAGES

- ✓ Giving stakeholders a sense of ownership can encourage them to support the enterprise.
- ✓ Involving employees can be good for staff morale and reduce staff turnover.
- ✓ Closer engagement can help with raising finance from stakeholders.
- ✓ Services can be better tailored to user/customer needs when there is a greater opportunity for direct input and/or feedback.

DISADVANTAGES

- ✗ Decision-making can be slower because a wider group of people need to be consulted.
- ✗ Stakeholder representatives may find it difficult to reconcile the interests of their stakeholder group with those of the organisation.
- ✗ Close involvement with the day-to-day running of the organisation can be a burden for stakeholders.
- ✗ Stakeholders may not want to be involved—stakeholder apathy.

Identifying stakeholders

A stakeholder is any individual or group that is affected by, or can influence, decisions or actions taken by your organisation. Some common examples of stakeholders for social enterprises are:

- Employees
- Members of the organisation
- Investors/grant makers/lenders
- Customers/service users and families
- The local community
- Local voluntary organisations
- The local authority

Involving stakeholders

Social enterprises often involve their stakeholders to a greater extent than many private businesses. This can often be a great source of strength to the business. However, it is worth giving careful thought to exactly how people can become involved, to ensure the business can be run effectively.

Stakeholder involvement is not an ‘all or nothing’ process, and there are several ways in which people can be involved, from being consulted to taking full control of the business. Some of the various methods of involvement are outlined below. No method is necessarily ‘better’ or ‘worse’ than any other, and different levels will be appropriate for different groups or

situations. You can include a wide variety of different methods of involvement in your organisational structure.

Group and integrated structures

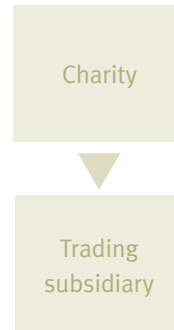
Sometimes it is desirable to set up more than one legal entity to run a social enterprise. The reasons behind this are usually tax efficiency, ring-fencing risk or the need for the clear separation of the management of different operations. Examples of this include:

A social enterprise or business with an associated charity to run the parts of its operation that can receive charitable status.

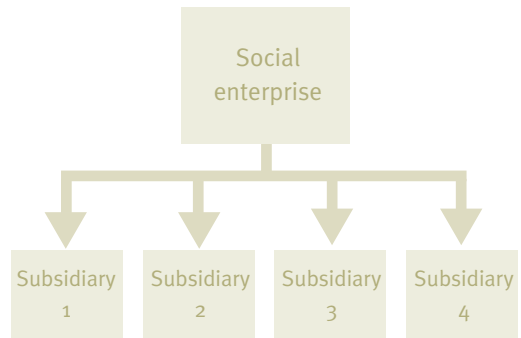


Here the charity will not wholly own the social enterprise, structurally it is the other way round.

A charity and its wholly owned trading subsidiary.



A social enterprise with one or more subsidiary companies.



Businesses often set up subsidiary companies to ring-fence particular risks. For example, one company may own property and lease it to a related operating company that deals with the service provision which is run from the building.

Methods of stakeholder involvement

Formal constitutional membership

These stakeholders have rights written into the organisation's constitution, and can attend and vote at Annual and Extraordinary General Meetings (AGMs and EGMs). You can expand or limit the range of issues that can be voted on by members as appropriate for the organisation through clauses written into your constitution.

Associate membership

Associate members do not have formal voting rights. However, this can be a good way of informally including interested groups or individuals as members of the organisation, and many organisations develop a membership scheme that provides information and services to associate members.

Direct rights of nomination or appointment or to be consulted

Such rights often belong to constitutional members of an organisation, but it is possible for other organisations or interest groups to have direct powers of nomination or appointment (nomination means proposing an appointee to be ratified by those with the power to appoint). Formal rights to be consulted in relation to appointments can also be provided.

'Ex officio'

This is where there is provision for an automatic appointment to the management committee because the individual holds another office. For example, in a voluntary organisation spin-off the constitution of the social enterprise might specify that the chairperson of the board of trustees of the charity will be an ex-officio management committee member of the social enterprise.

Advisory groups

This is a group consisting of people sitting either in their own right, as representatives of stakeholders, or as experts in a particular field. Their advice assists, but does not bind the board's decisions.

Committees

It is possible for the board to delegate consideration of issues and administrative decisions to committees on which stakeholders may sit or be represented. The members of the sub-committee need not be members of the board (unless this is written into the constitution).

Feedback

Stakeholders not included in the formal structure of the organisation may still be involved in policy decisions through informal consultation procedures such as meetings, surveys and questionnaires.

Hackney Community Transport

Company limited by guarantee (CLG) with charitable status and wholly-owned trading subsidiary

Business

Hackney Community Transport (HCT) provides transport options for people who are unable to use mainstream public transport. HCT's key aims are to provide transport services that meet everyone's needs regardless of traditional barriers. HCT is the largest community transport operator in the UK, and now provides a range of services from community transport to public bus routes in London.

Working out the organisational model

HCT is a company limited by guarantee (CLG) with charitable status. It has two wholly-owned trading subsidiaries, CT Plus, and CT Plus (Yorkshire) which are both companies limited by shares (CLS).

How it works

- HCT has 13 board members: seven are elected from the user forums, and they appoint a further six. The six appointees must be: one financier, one legal expert, two transport professionals and two social enterprise managers. The chair must be one of the seven elected
- The board of CT Plus is made up of the four chief officers of HCT and four senior officers from the HCT



board (Chair, Vice Chair, Treasurer plus one other). In practice this is usually weighted in favour of the appointees although the Chair is always one of the elected members.

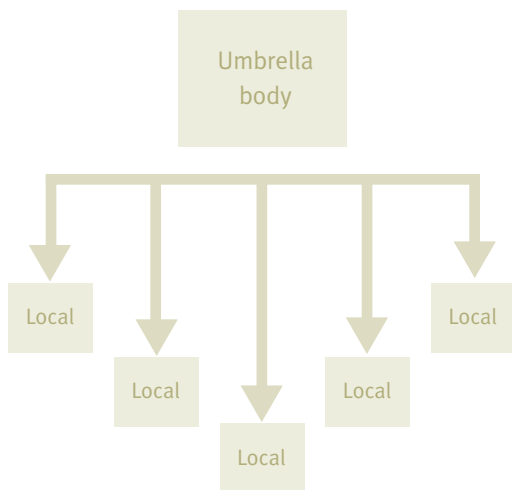
- The HCT board sets strategy but risk management within this is mainly delegated to the CT Plus board, which is made up of senior professionals with experience of risk management.
- HCT has an active user forum which meets at least twice a year, covering nine or ten distinct services (including the red bus routes). One member of staff is dedicated to this work.

See page 30 for more information on the CLG legal form.

Contact: info@hackneyct.org

Website: www.hackneyct.org/htm/mainfrm.html

Federations



Federations consist of one umbrella organisation and a number of local organisations. Each local organisation may have the umbrella organisation as its sole member, or the membership might be wider, with the umbrella organisation having power to direct significant aspects of the local organisation. Alternatively the local organisation may be constitutionally independent of the umbrella organisation, but controlled instead through a contract that franchises the business model and/or licences use of the brand name and logo.

Emmaus UK CLG with federal structure

Business

Emmaus Communities offer homeless and other socially disadvantaged men and women a home, work and the chance to rebuild their self-respect in a supportive, community environment. Companions, as residents are known, work full time refurbishing donated furniture and household goods and selling them in the Community shop. Each Emmaus Community aims to become self-sufficient through this activity. Individual Communities are established as separate charities in their own right and are CLGs.

Working out the organisational model

Emmaus UK has a federal rather than centralised structure in order to protect the grassroots nature of the individual Emmaus Communities. This allows the organisation to appeal on both local and national levels; local Communities feel ownership of 'their charity', but the federal grouping gives the organisation a national voice and profile.

How it works

- Each Community is run differently, but the general Emmaus ethos is to work with/alongside Companions rather than 'over' them. Communities will usually have regular meetings including both Companions and staff to decide on day-to-day issues, where decisions are taken on a broadly democratic basis.
- Communities are run by Community Leaders or, in some cases, managers and trustees are usually enlisted from local volunteers. Emmaus UK issues model Memorandum and Articles of Association, which follow good practice guidelines.
- The full members elect the Emmaus UK trustees. Each full member has 1 vote. The majority of trustees must also be trustees of members of the Federation and some Community staff members are also trustees.

The Emmaus UK board of trustees is limited to 12 elected by Federation members, with up to 4 additional trustees being added by the board themselves. The board meets 6/7 times a year.
- Trustees will deal with most business and lead on the development of Federation policy, but contentious issues may be referred by the board to the voting membership.
- Advisory groups and trustee committees operate alongside the full board. These are seen as an integral part of how Emmaus UK operates and the Emmaus UK staff are fully involved in their operation.



- The Emmaus Federation holds an annual national conference, known as the National Assembly, which all stakeholders can attend. This includes Companions, who are considered the most important stakeholder group. The AGM has taken place during the National Assembly in recent years, but consideration is being given to separating it from that event.

Key point

The federal structure allows Emmaus to operate on two levels: both local and national.

Contact: contact@emmaus.org.uk
Website: www.emmaus.org.uk

See page 30 for more information on the CLG legal form

each Emmaus community **aims to** become **self-sufficient**. Individual communities are therefore established as **separate charities** in their own right and are **CLG's**

Table comparing legal forms: Choosing/Planning your structure

	Company limited by shares (CLS)	Company limited by guarantee (CLG)	Community benefit society
Incorporated with separate legal identity?	Yes	Yes	Yes
Limited liability for members?	Yes	Yes	Yes
Unlimited liability for directors/committee?	No	No	No
Constitutional document?	Memorandum and Articles of Association	Memorandum and Articles of Association	Rules
Objects	Any	Any	Must be for the benefit of the community
Charitable?	Usually not	Can be	Can be
Regulator?	Companies House	Companies House	FSA
Registration with regulator?	Yes	Yes	Yes
Fees for registration?	£20	£20	£100-£950
Debt financing available?	Yes	Yes	Yes
Equity financing?	Yes	No	Not conventional equity
Protection of social purpose?	None unless charitable but some safeguards can be built into the constitution		FSA has to approve rule changes, and will protect purpose
Membership voting	Usually one share one vote, so voting is weighed in accordance with the size of the shareholding	Usually one member, one vote	Usually one member, one vote
Stakeholder involvement?	Possible in all	Possible in all	Possible in all

Co-operative society	Unincorporated association	CLS CIC	CLG CIC
Yes	No	Yes	Yes
Yes	Members are likely to incur liability unless there is an indemnity in the constitution	Yes	Yes
No	Yes	No	No
Rules	Various names can be used, eg constitution, rules	Memorandum and Articles of Association	Memorandum and Articles of Association
Must follow Co-operative principles	Any	Community Interest	Community Interest
No	Can be	No	No
FSA	None	CIC Regulator	CIC Regulator
Yes	No	Yes	Yes
£100-£950	N/A	£35	£35
Yes	Yes	Yes	Yes
Yes	Yes	Yes	No
FSA has to approve rule changes, and will protect purpose	None unless charitable but some safeguards can be built into the constitution	As CLS	As CLG
One member, one vote	As per the constitutional document – usually one member, one vote	As CLS	As CLG
Possible in all	Possible in all	Possible in all	Possible in all

Choosing a legal structure – decision tree

Incorporation?

Are You: Taking out a lease? Buying a property? Taking on employees?
Raising finance on scale? Entering into large contracts? Involved in risk?

NO to ALL these questions?

Unincorporated

Sole trader

Partnership

Unincorporated
association

YES to ANY of these questions?

Incorporated

Company

CLS

CLG

CLG
CIC

CLS
CIC

Industrial &
provident society

Co-operative
society

Community
benefit
society

incorporation

An incorporated business is a legal entity in its own right. This section considers the pros and cons of incorporating.

In this section

- What it means to be unincorporated
- Why incorporate?
- Why not incorporate?
- Summary of triggers which may indicate it is time to incorporate
- How to incorporate

What it means to be unincorporated

Being unincorporated means that the business has no separate legal identity of its own. The full risks and liabilities involved in running the business are taken on by the individuals who own and/or manage it. Unincorporated businesses can take the following forms:

Sole traders

Sole traders are individuals who set up on their own and are solely responsible for their business. There is no requirement for a constitution or registration. Sole traders may employ staff and trade under a business name.

Partnerships

A partnership is defined as ‘the relationship which subsists between persons carrying on a business in common with a view to profit’. Solicitors’ firms and GP practices are often run as partnerships. There is usually a partnership agreement regulating its affairs. If not (or to the extent matters are not covered by such an agreement), the provisions of the Partnership Act apply. There are no registration formalities.

Unincorporated associations

Unincorporated associations are groups that come together for a particular purpose, for example running a sports club. They usually have a constitution that sets out the rules that govern their relationship and a broad membership which elects a board (in this case

usually called a management committee) to run the organisation on behalf of the members.

The central feature of most unincorporated businesses is personal liability for the sole trader, partner or member of the management committee. That means that those individuals enter into obligations, such as contracts, on behalf of their organisation and they are responsible for its debts and other liabilities. If you are on the management committee of an unincorporated association your personal assets are at risk if the assets of the business are not sufficient to cover all the debts and liabilities.

Benefits of incorporation

1 Legal personality

An incorporated business is a legal entity in its own right. This means that it can enter into contracts, employ staff, lease property and have its own obligations and liabilities.

2 Limitation of risk

Incorporation limits the personal liability of its management committee, although it does not remove it altogether. Incorporation is an important consideration if the social enterprise intends to employ more than a few staff, take on significant property interests or undertake major contractual obligations.

3 Clear ownership structure/governance

Unincorporated organisations can operate relatively informally, being governed only by their constitutions. However, this means the powers and processes for decision making can be unclear. Incorporation involves the formalisation of governance structures within a legislative framework.

4 Developing a sense of ownership

Incorporation provides an established formal structure for stakeholder membership.

5 Public accountability

With limited liability comes regulation and disclosure requirements, which can increase public confidence in the company. Limited companies have to have a registered address, file their constitutions, annual accounts and prescribed details of their directors etc.

6 Recognition by financial institutions and investors

Paying off a loan is a major obligation for any organisation. Many banks and financial institutions will insist on incorporation before providing loan finance.

7 Availability of equity finance

Equity finance is only available to certain types of incorporated organisations. If you want to raise equity investment, your organisation will have to incorporate. See Chapter 4 for more details on share-issuing organisations.

Reasons not to incorporate

Although most social enterprises should probably seriously consider incorporating, there may be reasons why it is better for your organisation to remain unincorporated at this stage.

1 Light touch regulation

Being unincorporated allows greater freedom of operation. Whilst all incorporated organisations are regulated and have to register complete annual returns and file accounts by law, an unincorporated organisation is only required to comply with the normal statutory obligations of any business with regard to its management (eg. VAT registration, PAYE, health and safety, insurance).

More details Charities (which can be incorporated or unincorporated) are subject to specific charity law regulation in addition to the general law. See Chapter 5 for more details.

2 Tax advantages

Sole traders and partners pay their tax in arrears in January and July rather than upfront via PAYE. This can help cash flow. (PAYE will apply to their employees).

Reduced rate NI contributions are applicable to owners who are treated as self-employed.

Sole trader/partnership losses may be set against tax paid in previous years.

Summary of triggers which may indicate it is time to incorporate

- Taking on a lease
- Buying a freehold property
- Taking on employees
- Raising finance
- Entering into large contracts
- Risk management related to your product or service.

Emmaus UK CLG with federal structure

A decision to incorporate

Emmaus UK (see pages 18-19) started as an unincorporated organisation, but incorporating it as a CLG allowed the Federation to formalise its member involvement, establish criteria for identifying fully operational Emmaus Communities and ensure that the right people can be involved at the right level in the organisation. It also allows the National body to exercise some control and influence over local groups using the Emmaus name.



Contact: contact@emmaus.org.uk

Website: www.emmaus.org.uk

See page 30 for more information on the CLG legal form

Emmaus UK started as an
unincorporated organisation but
incorporating it as a **CLG** meant the federation
could **formalise** its member **involvement**,
allowing the national body to exercise some
control over **local groups**
using the Emmaus name

Options for incorporation

There are seven corporate vehicles commonly used by social enterprises:

- 1 Company limited by shares (CLS), or
- 2 CLS community interest company (CLS CIC)
- 3 Company limited by guarantee (CLG), or
- 4 CLG community interest company (CLG CIC)

5 Industrial and provident society (IPS) community benefit society (also known as 'society for the benefit of the community' or 'bencom').

6 Industrial and provident society (IPS) co-operative (also known as 'bona fide co-operative').

7 Limited liability partnership (LLP).

These are described in more detail in the next chapter.

An **incorporated** business
is a **legal entity** in its own right.
The business can enter into **contracts**,
employ staff and **lease property**.
Incorporation **limits** the personal
liability of management committee members

legal forms

There are three categories of incorporated organisation: the company, the industrial and provident society (IPS), and the limited liability partnership (LLP). The company form is by far the best known, but IPS forms are also commonly used by social enterprises. The LLP form is much newer.

In this section

- Companies
- Community interest companies
- Industrial and provident societies
- Limited liability partnerships

Companies

Companies have two types: companies limited by shares (CLS) and companies limited by guarantee (CLG). Community interest companies (CICs) are a type of company and can be either CLS or CLG. CICs are described in detail on page 36.

CLSs are divided into private companies (which make up the great majority) and public limited companies (plcs) which are subject to particularly stringent accounting standards and can offer their shares to the general public. Many (but not all) plcs are listed on the stock market so that their shares can be easily bought and sold. Although there are some plcs that are social enterprises, such as the Ethical Property Company (see page 34) they will very rarely be listed.

The CLG brand has been traditionally associated with charities, trade associations and not-for-profit companies. They are increasingly used in the not-for-profit world alongside the IPS. The main difference between the two forms is that a CLS has something called **share capital**, whereas the CLG does not. This share capital is a nominal figure which is used to represent the total net assets of the company. The usual share capital for a small CLS is £100.

The impact of the different legal forms is most clearly felt when you consider your financing options—different options are available for CLS and CLG forms. See page 33 for more details on the financing of companies.

Shareholders and members

A CLS divides its share capital into shares of fixed amounts and can then issue them to shareholders. They then become the owners of the company.

In a CLG there are no shareholders. Instead, the members give a guarantee to cover a company's liability. However, the guarantee is nominal, normally being limited to £1. The members of a CLG become its owners and have broadly the same powers as shareholders in a CLS.

Subject to contrary provision, shareholders and members have the powers to:

- Elect and dismiss the board of directors
- Appoint or dismiss the auditors
- Change the Memorandum and Articles of Association by special resolution. This is a resolution passed by 75% of the shareholders present and voting at a meeting for which at least 21 clear days notice has been given
- In a CLS, shareholders can also approve the payment of dividends.

Constitution

A company's constitution is contained in two documents:

- The Memorandum of Association contains the objects and powers, the amount of the

share capital (if it is a CLS) or guarantee (if it is a CLG) and a non profit distribution clause if relevant.

- The Articles of Association sets out the internal management structure and procedures, such as the roles of members and directors, procedures for their appointment and removal and for the conduct of meetings, and so on.

Most clauses contained in the Memorandum and all the Articles of Association can be changed by special resolution.

Safeguarding the social mission

All companies have an 'objects' clause in their Memorandum of Association. This sets out the company's aims or purposes (for example, 'to operate the business of recycling furniture'). It is possible to state that the object of the company is to carry on business as a 'general commercial company' in which case it may enter into any trade or business and do all such things as are incidental or conducive to carrying on any such trade or business. For a social enterprise, however, a more particular definition of the objects may well be desirable. For a charitable social enterprise the objects must be exclusively charitable (see Chapter 5).

The social mission of a social enterprise is often underpinned by a constitutional requirement that the profits of the company are (unlike those of a commercial company) not to be paid out to the members by way of

dividends, but instead have to be retained for application towards the company's social or public purpose. For charitable social enterprises this is essential and invariable.

For social enterprises which are not charities consideration could be given to ensuring the non-profit distribution provision cannot be changed by specific constitutional drafting. This may provide comfort to prospective funders (see also section 4 on CICs).

There may also be provision that in the event of dissolution of the company any surplus will not be divided among the members but will go to a social or public purpose. Most CLG constitutions contain a non-profit distribution clause and therefore the members do not have a right to a share in profits or any surplus on the winding up of a company. This is a required feature for all charitable companies. However, it is sometimes possible to allow specific communities or categories of members who need support to benefit from an ultimate distribution of surplus.

Officers

The board of directors forms the upper tier of the power structure in all companies. The directors are typically appointed by the shareholders/members. Their terms of office are dictated by the company's constitution, but typically they may remain in office for a fixed period of time, or indefinitely or they may retire in rotation each year at the AGM.

The directors have a duty to act in the interests of the company, and to exercise reasonable care in their management functions. However, a director is entitled to rely on fellow directors in the absence of grounds for suspicion. These duties are owed to the company and directors are not normally exposed to third party claims. There are, however, some circumstances in which these can arise, for example in an instance of wrongful trading. It is possible to take out directors' and officers' liability insurance to cover such potential liabilities in the absence of fraud, or other bad faith.

Every company will designate one of the directors as a chair (even if only meeting by meeting) and have a company secretary. The chair is normally elected by the board of directors. He or she serves as the first among equals and may have a casting vote in the event of deadlock. The company secretary is usually responsible to the board for basic company law compliance, such as maintaining the company's statutory books and attending to routine obligations such as filing accounts with HM Revenue and Customs. The secretary need not be a director.

It is usual for the board to delegate management functions to a managing director (who would not usually be subject to retirement by rotation) or the senior employee below board level (the chief executive). It is usual to have another director who is specially responsible for the company's financial affairs.

In the case of a plc, or a private company that is a subsidiary of a plc, the age limit for serving as a director is 70.

A person may be disqualified from being a director of a company by court order. This will be given where a director has:

- Been ruled to be unfit to be concerned in the management of a company
- Been convicted of certain criminal offences.

Registration

Registering a company is very simple. There are often standard forms of Memorandum and Articles of Association that can be used (although you should be wary of using these without checking with a legal expert that they are appropriate to your organisation). Once you have agreed your constitution, an application to incorporate is submitted and is processed by Companies House within seven days. The incorporation fee is currently £20, and a same day incorporation costs £50. It is also now possible to submit these documents electronically relying on identification details rather than signatures. Electronic incorporation costs £15 or £30 for the same day service.

Regulation

Companies are required by law to make public certain information. The key disclosures are:

- An annual return which has to be forwarded to the Registrar within 42 days of the annual

general meeting plus a £15 fee if it is sent electronically or a £30 fee if it is sent on paper

- Audited accounts which have to be filed with the Registrar within 10 months of the end of its financial year. If a company's turnover is less than £1 million per annum, it does not have to produce audited accounts (this threshold is less for a charitable company). However, it may be desirable to have them audited anyway to give assurance to external supporters, investors and other stakeholders.
- Details of changes of directors and the company secretary, constitutional amendments and other disclosable matters have to be filed with the Registrar within 14 days.

Financing

A CLS can be financed by grants, loans (secured and unsecured) and by equity. However, although CLGs may receive grants and take out loans, equity finance is not available to them.

SECURITY

Companies have to register a mortgage (usually called a charge) over land, vehicles and other property at Companies House within 21 days of its creation. They are also obliged to register mortgages over property with the Land Registry. Unincorporated businesses only have

to register mortgages over property, which means it is easier for lenders to check how much security a limited company has given compared with an unincorporated business.

Unlike unincorporated businesses, limited liability companies can give a 'floating charge' which applies to assets that change or fluctuate, for example stock or debtors. The floating charge hangs like a net above the assets charged. At the moment the charge is triggered, the net drops and covers all the charged assets at that moment ('crystallises' in legal jargon). So, for example, all the stock owned by the company (and not subject to a prior charge) at the moment the floating charge is triggered becomes security for the debt due to the lender and secured by the floating charge. The floating charge is only triggered when certain conditions set out in the terms of the charge or loan facility under which the charge was given take effect.

EQUITY FINANCE

Equity finance involves a company selling shares in itself, and so is only available to a CLS.

Dividends are paid from generated surpluses and are not therefore a cost of the business, unlike interest on a loan. Shareholders are only rewarded if there are profits available for distribution, and in the lean years they get nothing. If there is a loss brought forward on the balance sheet this must be expunged by saving

The Ethical Property Company

Company limited by shares, unlisted plc

Business

The Ethical Property Company is a unique initiative in ethical investment. The company buys properties and develops them as centres that bring charities, co-operatives, community and campaign groups together under one roof where they can share skills and ideas. Groups in The Ethical Property Company's centres benefit from reasonable rents, flexible tenancy terms and office space and facilities designed to meet their needs.

History

The Ethical Property Company dates back to 1982 with a property in Bristol bought to house some of the many co-operatives springing up in the area. The building offered its tenants reasonable rents, a benign and supportive landlord, a secure and welcoming place from which to work and the chance to share premises and resources with a range of like-minded organisations. The founder gained from a secure investment that produced a financial return as well as generating a strong social benefit.

In 1998, after several years of research and development, its founders decided to form The Ethical Property Company plc, and the company's properties in Bristol and London were transferred into the company. With the help of Triodos Bank a share issue was launched in May 1999. This closed in December 1999, having raised £1.72 million. The company invested these funds in setting up seven new centres in Bristol, London, Leeds and Oxford.



With the funds from the second share issue, new centres were set up in London, Sheffield, Brighton and Manchester, taking the total number of centres to 12.

Reasons for choosing this legal form

Transparency is important to the Ethical Property Company, and for that reason they wanted to choose a legal form that was widely known and easy to understand. This has allowed them to appeal to investors that might not otherwise have considered investing in a social enterprise.

There were additional reasons why other legal forms that might have been considered weren't appropriate in this context. Large investors would expect their votes to be proportional to the amount invested, so the Ethical Property Company did not want to institute one-member, one-vote co-operative rules. It could not incorporate as an IPS, as IPS rules would have meant that shareholders could not invest more than £20,000, whereas the largest investment is currently £881,000.

How it works

- Rather than developing a more complex legal form to protect its social mission, the Ethical Property Company works to develop a strong socially-minded culture amongst its investors, employees and tenants.
- The company carries out in-depth and transparent social accounting, involving its employees,

shareholders and tenants, and aims to act on the results of its findings. For example, it carries out salary audits of its tenants and seeks to keep its own pay scales in line with its customer base. It aims to make its landlord-tenant relationship a co-operative one.

- The company has chosen not to list on the stock exchange, as it feels that the listing rules it would need to follow (particularly the requirements around liquidity of shares) might be destabilising to the organisation. Instead it trades shares on a matched bargain market.
- There is no maximum individual shareholding. The organisation did originally have right of refusal on new investors but has decided to remove this from its rules, feeling that prospective investors are clear about the social mission of the organisation.

Key points

The Ethical Property Company has chosen not to directly 'lock in' its social mission via rules contained in its constitution. Instead it works hard to develop a strong values-driven culture in the organisation, feeling that this is a better way to embed the mission in the organisation in the long term. The tried and tested legal form means that investors can easily understand their relationship with the organisation. This has perhaps meant that the Ethical Property Company has been able to lever in funds that might not otherwise have been available to a social enterprise.

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profits before dividends can be paid. Equity therefore has the advantage of being 'patient' finance. However, if the company goes into liquidation shareholders are paid last. As a result, they can often expect a higher return for their investment.

Share capital has a positive impact on a company's balance sheet, as it is classified as an asset. This is in marked contrast to a loan, which is treated as a liability. Consequently, a company that is financed by borrowings, for example from its parent charity (if a trading company) or from supporters, will find it very difficult to borrow money from a bank since the bank will regard it as already highly 'geared'. On the other hand, if it has a reasonable amount of paid up share capital this should give it a stronger balance sheet, providing an asset based upon which a bank can take security.

Share ownership can bring a sense of involvement, and this has been used to good effect by companies that encourage share ownership among staff, or by social enterprises issuing shares to 'social investors'.

Shares are potentially transferable, thereby allowing an investor to realise his or her investment. However, many small private companies' Articles of Association contain severe limitations on the ability of the shareholders to transfer their shares, and often the directors have a complete veto over allowing share transfers. This is to protect the

other shareholders. In the case of a plc, it is highly unlikely that any social enterprise will be listed on the stock market, making it harder to trade shares freely. However, buyers and sellers can be linked up in share sale matching schemes. There are similar matching services offered for private company shares in certain circumstances.

Community interest companies (CICs)

The CIC was developed in order to address the lack of a legal vehicle for non-charitable social enterprises. Both IPSs and the existing company forms were insufficient solutions as they did not allow for a lock on assets (although this is now changing for IPSs) and charities were not suited to social entrepreneurs who wished to both control the organisation and receive a salary from it.

CICs are types of company. They may be limited by shares or by guarantee and they may be plcs. Certain companies are excluded from being community interest companies; these are ones which are political parties, are controlled by political parties or are engaged in political activities. The rules regarding what are political activities and the extent to which a CIC may engage in such activities are similar to the rules regarding charities and political activities. Charitable companies cannot also be CICs.

ECT Group

Community interest company within hybrid structure

Business

ECT is a social enterprise committed to providing better services for the community. Originally a community transport organisation, it has diversified into a range of services, including refuse and recycling collection, community rail, public bus transport and primary healthcare.

History

Ealing Community Transport started in 1979 as the transport arm of Ealing Voluntary Service Council. It took six years to develop it as a sufficiently effective organisation to 'spin off' as an independent organisation. It was incorporated as an IPS community benefit society, because at the time it was important for it to be both commercial and charitable—it was still operating on a mix of grant funding and payments for services.

With later subsidiaries the decision was made to create a subsidiary organisation as a company limited by shares (ECT Group) with a number of subsidiaries itself, of which some were companies limited by shares and some were companies limited by guarantee. This was primarily because the activities it was moving into, such as recycling, were not at that time considered charitable (although they now can be). Creating subsidiary companies therefore ensured the charitable status of the parent organisation was not jeopardised. It also ensured that if one of the subsidiaries became insolvent the others were not affected. ECT Group and some of its subsidiary companies have now been converted to Community Interest Companies (CICs).

Reasons for choosing this legal form

ECT has grown and developed over time, and each



development has been in response to a current issue. The IPS was set up because Ealing Community Transport was a community-focused organisation. It was felt that although the commercial subsidiaries provided a pragmatic solution they could potentially weaken that community focus. Converting these companies to CICs allow ECT to reinforce the social mission of each company.

How it works

- The parent company, Ealing Community Transport, is an IPS community benefit society. ECT Group is a CIC company limited by shares and is wholly-owned by Ealing Community Transport.
- The Ealing Community Transport board delegates oversight of the running of the business to the ECT Group board, which includes representatives of the parent company board and senior staff members.

Key points

ECT's decisions about its organisational and legal form have developed over time, and have often been pragmatic responses to the situations they have found themselves in.

The CIC form has allowed ECT to reinforce its commitment to the community throughout its entire structure, making explicit the community benefit of each of its subsidiary companies.

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Website: www.ectgroup.co.uk

CICs operate in a broadly similar way to normal companies, except in certain aspects described below.

Constitution

Just like ordinary CLSs and CLGs, a CIC's constitution is its Memorandum and Articles of Association. In addition, the CIC legislation requires that the Memorandum and Articles of Association of a CIC must contain certain protections. Model constitutions for different types of CICs can be found on the CIC Regulator's website: www.cicregulator.gov.uk.

Safe-guarding the social mission

The principal feature of a CIC is that it contains a lock on its assets. This prevents profits being distributed to members or shareholders other than in certain circumstances. A CIC is obliged to pursue the community interest and must report on how it does this to the CIC Regulator.

Registration

A CIC is registered with Companies House in the same way as a normal company. However, there is one additional form to complete which contains: a statement that the CIC is pursuing the community interest (including a description of the community and how its interest is pursued); and a declaration that the company is not an excluded company.

Companies House will pass the application to the CIC Regulator who will assess whether the 'community interest test' has been passed. If it has, the CIC Regulator will return the application to Companies House, which will then incorporate the company. Currently the fee for registering a new CIC is £35.

A normal CLS or CLG can be converted to a CIC. It would need to amend its constitution appropriately and then submit the required forms to Companies House.

Regulation

CICs are regulated by the CIC Regulator and it is intended that the regulation will be 'light-touch'. However, the CIC Regulator will respond to complaints from stakeholders and has considerable powers to act to protect the community interest.

A CIC is required to file a community interest report each year. This report must include details of the remuneration of directors, dividends paid on shares and interest paid on certain types of loans. It must also explain how it has pursued the community interest and how it has involved stakeholders.

Financing

A CIC limited by shares or guarantee will be able to accept grants and take out secured and unsecured loans in the same way as a normal company. Interest rates on CIC borrowing must

be at normal commercial rates, and performance-related interest is restricted.

A CIC limited by shares will also be able to obtain equity finance. However, there are limits on the return that may be paid to investors. In the case of a loan where the interest payable is performance related the interest cap is 4% above the Bank of England base rate.

There is a dual cap in respect of dividends: no dividend as a percentage of the paid up value of the share can be higher than 5% above the Bank of England base rate at the time the shares were issued and the aggregate dividends paid by the CIC must not be greater than 35% of the CIC's distributable profits.

If the shares are bought back by the CIC from the investor they can only be bought back at par.

Guidance is available on the CIC Regulator's website at :

www.cicregulator.gov.uk

Industrial and provident societies (IPSS)

Note that IPSSs are societies, not companies.

As with companies, IPSSs take two forms: community benefit societies and co-operative societies. The difference between the two is in the stakeholder groups that the society is set up to benefit. A co-operative is set up to benefit its members, whereas a community benefit society is set up to benefit the community more widely, whether people are members or not.

An organisation may be registered as a co-operative society if its rules reflect the values and principles given in the 'International Co-operative Alliance – Statement on the Co-operative Identity'.

Co-operative principles

- Voluntary and open membership
- Democratic member control
- Member economic participation
- Autonomy and independence
- Education, training and information
- Co-operation among co-operatives
- Concern for the community

www.coop.org

The legislation requires that a community benefit society must have some special reason for seeking registration as a society and not as a company. In practice this means including a standard constitutional provision requiring that

benefits will not be returned to its own members, demonstrating that business will be conducted for the benefit of the community, and typically including an attachment to the co-operative principle of one member, one vote, regardless of contribution.

No individual is permitted to own more than £20,000 of capital in any society. In community benefit societies, the members commonly only hold a nominal amount of share capital.

This maximum does not apply to:

- Members who are also registered Industrial and Provident Societies;
- Local authorities who have acquired a holding by virtue of the Housing Associations Act 1985.

The rules may lay down a minimum level of shareholding required as a condition of membership. Though different categories of shareholders may be recognised (for example consumers and employees), different classes of voting would contravene the principle of one person, one vote. It is also not possible to pay a dividend by reference to size of shareholding.

The main advantage of a society is that provisions may allow for the society buying back or 'redeeming' share capital if it is issued in the form of withdrawable shares. The rules of the society must state whether its shares are withdrawable and if so what the relevant rules are. The rules may provide for notice to be given, or for a limit on the proportion of the share capital which may be withdrawn. A

society with withdrawable shares cannot engage in banking. Transferable shares are also permissible. Provisions covering the forfeiture and cancellation of shares are generally included in the rules, there being no statutory provision.

Members

In co-operative societies it is mandatory for voting to be on a one member, one vote basis, whatever the shareholding.

In community benefit societies it is standard (though not mandatory) for voting to be on a one member, one vote basis, whatever the shareholding.

In both cases this contrasts with a CLS, where the number of votes is normally based on shareholding. In a CLG the position is usually one member, one vote.

Co-operative societies are obliged to have voluntary and open membership, as it is one of the co-operative principles. Membership is commonly open to anyone who is over 16 years old. Corporate organisations such as companies and other societies can also be members if their objects permit it. Unincorporated associations cannot be members unless they nominate a representative.

Community benefit societies do not have to have voluntary and open membership, though they may and frequently do choose to do so, particularly where they are seeking charitable

status and/or public sector or community and voluntary sector grant funding.

In either type of society the members normally have the following powers:

- To elect and dismiss the board of directors or management committee.
- To appoint and dismiss the auditors.
- To change the rules by special resolution.
- To approve a transfer of engagements, amalgamation or conversion (see the following section).

Constitution – ‘Rules’

Whilst it is possible to register a bespoke set of rules with the FSA (subject to its regulatory approval), it is less expensive to adopt (in whole or in part) model rules registered by one of the recognised sponsoring bodies. There are a number of different sets of model rules available in relation to different types of organisation. Amendments to rules are subject to approval by and registration with the FSA.

A further distinction from companies is the ability of societies to merge by a statutory process known as ‘transfer of engagements’. Through resolutions of its members a society can transfer all of its assets and liabilities to another society or to a company. This simple and effective mechanism has been used extensively by societies, and is a cheap and convenient process for corporate change.

It is also possible for two societies to amalgamate and both transfer engagements to a new society or company; for a society to transfer engagements to a company; and for a society to convert into a company. However, in most cases the original intentions behind the establishment of a community benefit society would, in practice, preclude the FSA’s acceptance of its conversion into a co-operative society.

It is possible to include provisions in the rules to reinforce its intended status and structure. This can be done, for example, by requiring a higher majority to change particular rules, or requiring an increased quorum at any meeting considering particular changes. It is also possible to provide in the rules that certain changes cannot be made without the approval of a public or statutory body (eg. a local authority, or a sector regulator).

Status as an ‘exempt’ charity (recognised by the government for tax purposes) establishes entitlement of public benefit purposes through general charity law principles.

Safe-guarding the social mission

In most co-operatives, surplus distribution is permitted, but may be overlaid by a governing principle supported by the members focusing on a broader social or community purpose over and above return on investment. No distribution to members is permitted in a community benefit society.

On a winding up, members of a community benefit society only have a right to the return of their capital. They do not have a right to a share of the underlying assets (or equity), and the rules normally make alternative provisions for the application of any surplus on a solvent winding up.

The Industrial and Provident Societies Act 2002 introduces similar protection against demutualising societies to that already applying to building societies, by providing that any transfer of engagements or conversion to a company can only proceed if, as well as being passed by a special resolution, a majority of members takes part in the vote.

The Co-operative and Community Benefit Societies Act 2003 gives the Secretary of State power to make regulations allowing societies to provide that their assets are dedicated permanently for that purpose and connected purposes. The Community Benefit Societies (Restriction on use of assets) Regulations (created under the above Act) came into force on 6 April 2006. They provide that where a society has a restriction on use of the assets, the assets may only be used in the ways allowed by the restriction. The remainder of the legislation deals with requirements for headings on stationery; execution of documents; power of the committee to bind the society and other provisions which bring the legislation into line with Company law.

Officers

As in a company, power is shared between the members in general meetings, and the board of directors. The method of appointment to the board or committee varies, but a board or committee member must be at least 18 years old and (usually) a member.

All societies have a board or committee, and a secretary. The secretary's administrative role in a society is often an important one given its membership structure.

Directors of a society owe fiduciary duties and duties of skill and care, which are similar to those owed by directors of companies.

Registration

Societies are registered with the Financial Services Authority (FSA), rather than Companies House.

Charitable community benefit societies do not have to register separately with the Charity Commission. They are recognised as charitable by HM Revenue and Customs and have the status of 'exempt charities' (ie exempt from registration with the Charity Commission). They thereby enjoy all the fiscal benefits of charitable status and a rather lighter regulatory regime. However, The 2005 Charities Bill anticipates the end of the 'exempt' status for societies so that they will become subject to

registration with and regulation by the Charity Commission. See Chapter 5 for more details.

Co-operatives are established, by definition, for member benefit rather than public benefit. They cannot therefore be charitable, except possibly in a case where a necessary condition of membership is to be within a class of charitable beneficiaries (for example, being resident in an area of deprivation).

The registration fee is dependent on the rules to be adopted by the new society. The fee is £100 for a society with model rules laid down by a recognised sponsoring body (such as Co-operatives UK). This fee increases with each amendment to the model rules, with a fee of £950 for an entirely new set of rules.

Regulation

Unlike the role of the Registrar of Companies in relation to companies, the FSA has a significant regulatory function in relation to registration. Only societies which meet the social criteria defined in the Act can be registered, and the FSA monitors continuing compliance with these criteria by having to approve any constitutional change. The FSA has the power to suspend or ultimately to cancel registration if a society does not adhere to its registered purpose.

The key disclosures to be made are:

- an annual return (containing revenue accounts and a balance sheet) to the Registrar within seven months of the end of

the period covered by the return. If the society is required to have its accounts audited the annual return must also be accompanied by the auditors' report. The annual return also gives details of the society's officers.

- A society with a turnover of £350,000 or less (£250,000 or less if they are charities) can opt out of a full audit of their accounts, and those with a turnover of less than £90,000 and a balance sheet total of less than £1.9 million can opt out of any audit.

Financing

Like the limited company, a society can mortgage its assets to a lender by granting charges over its assets. Such a charge must be registered with the FSA within 21 days of the date of the document. The insolvency regime governing societies was changed by the Enterprise Act 2002, which extends insolvency law applying to companies to societies.

The power of a society to borrow depends upon its rules (as with a company). The rules are required to state whether or not the society has power to borrow or take money on deposit, and if so on what conditions, with what security and up to what maximum level. The maximum borrowing limit must appear in the rules of a society but the Act does not give any indication of what that limit should be (as with a company).

The Phone Co-op

Consumer co-operative

Business

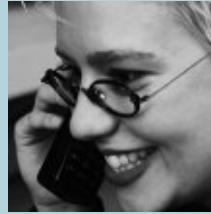
The Phone Co-op is the UK's only telecommunications co-operative, supplying phone and internet services to its customers, including individual consumers, co-operatives, charities and other not-for-profit organisations. As a co-operative owned by its customer members, The Phone Co-op distributes back to its members any profits which are not re-invested, via a dividend based on each member's spend and through a loan fund which supports other co-operatives. Turnover in the year to August 2005 was £5.1 million.

History

The Phone Co-op started trading in 1998, as a provider of telecommunications services aimed mainly at voluntary organisations and social enterprises. Initially, membership was restricted to these organisations. However, in 1999 it opened up membership to all customers including individuals. At this point it converted from a CLG to an IPS co-operative form.

Reasons for choosing this legal form

The organisation changed its structure primarily to raise equity finance from its members, but also to adopt a well-recognised consumer co-operative structure which enabled members to feel part of the co-operative through their investment. In a typical consumer co-operative members put in withdrawable capital as they join (and can add to it later), so the amount of capital grows in line with growth of the business. In February 2006 a total of £1.2 million had been raised from 6,000 members. Members' share accounts remain on the balance sheet, and do not have to be renewed each year.



How it works

- The Phone Co-op works to traditional consumer co-operative rules, based on Co-operatives UK's model rules.
- Co-op members receive information on the organisation through various communications and the annual report and AGM. In addition, there are informal meetings between the staff and board. Any member can stand for the board, although employees and 'materially dependant suppliers' are restricted to two places on the board and senior managers and their family members can't stand. Elections are held by postal ballot and turnout is usually high.

Key points

The Phone Co-op has taken the tried and tested consumer co-operative model and adapted it from use in high street retailing to a high-tech/utility based around services which used to be provided by the state.

The IPS co-operative model gives the organisation access to a flexible and appropriate source of finance.

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Limited liability partnerships

A limited liability partnership (LLP) is a new form of legal entity. It retains the organisational flexibility of a partnership and is taxed as a partnership but members have the benefit of limited liability. It is a body corporate (ie. it is a legal personality separate from its members) with unlimited capacity. It is a single tier structure (ie. the members are the equivalent of directors of a company and vice versa). Two or more individual or corporate bodies who carry on a lawful business with a view to profit may form an LLP.

Members

The members sign up to the incorporation document, or join by agreement with existing members. Individuals or corporate bodies may be members of an LLP.

A person may cease to be a member of an LLP by death, dissolution, in accordance with an agreement with the other members or, in the absence of agreement, on 'reasonable notice' to the other members.

The rights and duties of members have to be governed by agreement between members (and the LLP) or in the absence of any LLP agreement, there are default provisions for LLPs:

- no person may be introduced as a member or transfer their interest without the consent of all members

- every member may take part in the management of the LLP
- no member shall be entitled to remuneration for acting in the business or management of the LLP
- a member cannot be expelled unless a power to do so has been conferred by express agreement between the members.

The default regime also puts additional duties on each partner:

- to account for profits from any competing business
- to render true accounts and full information of all things affecting the LLP to any member or his legal representatives
- to account for secret profits.

Every member of an LLP is the agent of the LLP. An LLP is not bound by anything done by a member in dealing with a person if:

- the member in fact has no authority to act for the LLP when doing that thing
- the person knows that he has no authority or does not know or believe him to be a member of the LLP.

Liability continues after a person ceases to be a member unless:

- the person has notice that the former member has ceased to be a member of the LLP

- notice that the former member has ceased to be a member of the LLP has been delivered to the Registrar of Companies.

Members are liable in the winding up of an LLP up to the amount they have agreed (which can be nothing).

Where a member of an LLP has either ceased to be a member or has died; has become bankrupt; has granted a trust deed for creditors; or has assigned the whole or part of his share in the LLP (absolutely or by way of charge or security), then he, his personal representative, trustee or assignee may not interfere in the management or administration of any business or affairs of the LLP. This does not affect any right to receive an amount from the LLP in that event.

‘Designated members’ have the same rights and duties as any other member. Members become designated members on incorporation or in accordance with the LLP agreement. If there would be none, or only one, everyone is designated. An LLP can change the designated members from time to time; if a person ceases to be a member they cease to be designated.

Designated members have extra responsibilities (this can be an onerous role):

- appointing an auditor
- signing the accounts on behalf of the members
- delivering the accounts to the Registrar of Companies

- notifying the Registrar of Companies of any membership changes or change to the registered office address or name of the LLP
- preparing, signing and delivering to the Registrar of Companies an annual return
- acting on behalf of the LLP if it is wound up and dissolved.

Constitution

An LLP is governed by a partnership agreement. There is no requirement to file this at Companies House.

Safe-guarding the social mission

Unlike a limited company, an LLP has no Memorandum & Articles of Association, but can be governed by a partnership agreement tailored to suit the social purpose.

Officers

Unlike limited companies, there are no directors, shareholders or company secretary.

Registration

For an LLP to be incorporated the incorporation document Form LLP 2 together with registration fee (standard registration fee £20, premium same day service £50) must be delivered to the Registrar of Companies. The form sets out:

- the LLP’s name
- where the registered office of the LLP is

situated and the address of that registered office

- the name, address and date of birth of each of the persons who are to be members of the LLP on incorporation, or their registered or principal office if a corporate body
- which of these persons are to be designated members or that all members are designated members.

All members and designated members must sign and date the incorporation document to confirm their consent to act as a member of the LLP.

Regulation

The price of limited liability is disclosure. Accounts must be prepared in accordance with the relevant accounting rules and filed at Companies House. They must disclose the highest paid member's profits. The annual return must be completed for which there is a £30 filing fee.

As with limited companies, there is certain information that must appear on the LLP's correspondence, such as the full name of the LLP including the words 'limited liability partnership' or the abbreviation 'LLP', the place of registration, the registered number, the fact that it is a limited liability partnership and the address of its registered office.

Financing

An LLP owns the assets of its business. Members are only liable to the extent of their capital contributions. LLPs have no share capital and, unlike companies, are not required to maintain a minimum capital.

The share of capital, including capital profits, can be expressly agreed in the LLP agreement. If the LLP agreement does not address capital shares, default provisions apply so that members are entitled to an equal share in the LLP's capital and profits.

Profits are formally given to members by 'division', which is similar to issuing a dividend. Profit sharing arrangements may be set out in LLP agreements, otherwise profits are shared equally. Undivided profits are, in effect, the equity of the LLP.

The LLP, as a separate legal entity, can borrow in its own right and is liable for its debts. However, lenders may require personal guarantees from members.

An LLP is able to issue debentures and give fixed charges and floating charges over its assets in the same way as a company. Sections of the Companies Act 1985 apply to LLPs when these are issued. Details of any mortgage or charge created by the LLP must be registered at Companies House, and if a register of debenture holders exists, the LLP must notify Companies House of its location.

2amase

Limited liability partnership (LLP), operating as a worker co-operative

Business

2amase is a workers' co-operative of social enterprise support professionals, which provides expertise in social enterprise in three distinct areas: training, consultancy and research. Their main area of operation is London and the South East, but they have also worked in Scotland and across the regions.

To date the group has worked with and provided services for charities, established and start-up social enterprises, local authorities and regional and national umbrella bodies. 2amase has designed and delivered a new social enterprise start-up training programme for social entrepreneurs; provided a range of consultancy services to organisations (both large and small) interested in reviewing their sustainability; and designed and carried out a number of research projects.

The members all come from either a voluntary or public sector background, and all have worked at all levels, from grassroots volunteer to senior management. The result is that 2amase is 'in tune' with the needs of community and voluntary organisations, charities, community and social enterprises and those public bodies that support them.

Reasons for choosing this legal form

The group wanted to operate as a worker co-operative. They also wanted to incorporate 2amase in order to limit their individual liabilities, and to fit the requirements of some of their funders. However, as consultants they also wanted to retain the flexibility of being self-employed, so did not want to be employed by a company limited by guarantee. The LLP form covered all three requirements.



How it works

- 2amase has a written constitution and partnership agreement that enshrines the principles of a worker co-operative. Although the partners did not need help in setting up the LLP, they did retain a solicitor to draw up these documents.
- The constitution sets out rules for democratic decision-making. Only full members are involved in this process.
- 2amase has a number of associate members. These consultants do not participate in the democracy of the organisation, but there is a process by which they can become full members should they wish to.

Key points

Because it started as a larger group members were interested in operating as a worker co-operative—if it had started smaller it maybe would not have developed in this way. However, having set up as an LLP they have the flexibility to grow from a solid base.

The LLP form is itself very flexible. However, rules of working and protections can be enshrined in a written constitution.

Contact: info@2amase.org.uk
Website: www.2amase.org.uk

charity

and charities social enterprises

This section looks at social enterprises
also being charities.

In this section

- What is a charity?
- Charities and social enterprises
- Key features
- Charity trustees
- Regulation of charities
- Taxation of charities
- Rate relief for charities
- Charities and trading companies
- How social enterprises can obtain funding from charities

What is a charity?

Charities can be established in England, Wales, Scotland or Northern Ireland under four heads of charitable purposes:

- To relieve poverty
- To advance education
- To advance religion
- For other purposes beneficial to the community.

At the time of going to print, Parliament is considering a draft Charities Bill which includes 13 heads of charitable purposes:

- The prevention or relief of poverty
- The advancement of education
- The advancement of religion
- The advancement of health or the saving of lives
- The advancement of citizenship or community development
- The advancement of the arts, culture, heritage or science
- The advancement of amateur sport
- The advancement of human rights, conflict resolution or reconciliation, or the promotion of religious or racial harmony or equality and diversity
- The advancement of environmental protection or improvement

- The relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage
- The advancement of animal welfare
- The promotion of the efficiency of the armed forces of the Crown
- Any other purpose analogous to the above.

If this becomes law it will apply in England and Wales and is essentially a re-statement of the existing law. Scotland has already introduced legislation which includes a similar but not identical list. Northern Ireland is currently reviewing charity law and may legislate in this area in future.

It is possible to establish a charity using a variety of legal forms including a trust, an unincorporated association, a company limited by shares, a company limited by guarantee, an industrial and provident society, a body established by Royal Charter and a statutory corporation. The most common legal forms are company limited by guarantee, unincorporated association, trust and an industrial and provident society.

Charities and social enterprises

Many social enterprises are also charities – a recent survey by the DTI Small Business Service found that an estimated 64% of social enterprises had charitable status. On one hand, operating a social enterprise through a charity offers very obvious tax and rate relief advantages. On the other hand, the organisa-

tional constraints that come with charitable status may make charities inappropriate vehicles for operating a social enterprise.

Key features

The key feature of a charitable social enterprise is that it has to be established with exclusively charitable objects. The directors of a charity are most often called trustees, and they are the people responsible for its administration and management. Trustees are normally unpaid. It is possible to have one paid trustee if the constitution allows but this is unusual.

A further crucial feature of a charity is that any profits or surpluses cannot be paid out to its members but have to be ploughed back into the charity and used to fulfil its charitable aims. Consequently all charities have a non profit distribution clause. Charities are public benefit organisations. They are established to benefit the public and this means they have to be careful about not giving disproportionate levels of private benefit to any particular group or person.

Finally, a key element in charity law is that the assets must always be used to further the charity's purposes. Once a charity always a charity.

Charity trustees

Because of the fundamental rule that trustees are unpaid often the founder of a charity does not serve on the board of trustees. It is

sometimes possible to make an exception for a key person but it is certainly not possible to allow the employees in general to serve on the board. This can be a key sticking point for founder(s) and employees who wish to be involved in the strategic direction of the business.

The Charity Commission is concerned to ensure that charities do not become alienated from their beneficiaries. Therefore, with appropriate safeguards, Commission consent and constitutional authority, users may serve as trustees.

Regulation of charities

The great majority of charities in England and Wales are regulated by the Charity Commission. In Northern Ireland they are regulated by HM Revenue and Customs, and in Scotland by the Office of the Scottish Charities Regulator (OSCR).

In England and Wales there are also exempt charities. These are charities which are exempted from having to register with the Charity Commission because they are subject to regulation by another governmental body. Universities are for example exempt charities as they are regulated by the Higher Education Funding Council.

For social enterprises there is one very important category of exempt charity: a charitable industrial and provident society. A social enterprise has to satisfy the Financial Services Authority that it has a valid reason for

becoming a charitable society. If it can, then this can be a very attractive route as the social enterprise obtains the equivalent of charitable status in England and Wales without Charity Commission regulation. Instead its charitable status will be recognised by the Inland Revenue in applying the income/corporation tax benefits available to charities. However, this is set to change if the Charity Bill becomes law as it removes the exemption. Unless the Society is a Registered Social Landlord (housing association) it will be regulated by the Charity Commission and if it has an annual income of more than £100,000 it will have to register.

The Charity Commission is an increasingly active regulator, particularly compared with Financial Services Authority or Companies House in their regulation of IPSs and companies respectively. This has an impact in two ways:

- 1) On registration the Charity Commission operates a gateway policy whereby it seeks to establish whether, to its satisfaction, a proposed new charity is suitably well organised and committed and has sufficient resources to merit registration. The whole process can take at least three months. It can also be expensive because an applicant may well need professional advice in order to help it through the registration process.
- 2) Once registered, the Charity Commission exercises considerable scrutiny over charities, particularly those turning over more than £250,000 per annum. Charities with an annual income of more than £10,000 have to file

annual reports, accounts and an annual return. If the charity's annual turnover is more than £250,000 the accounts have to be audited (the Charities Bill, if passed, is likely to increase the threshold of £500,000 and introduce an additional asset value threshold of £2.8 million for charity with an income of over £100,000). This is £750,000 less than in the case of a non-charitable limited company. Charities with a turnover of less than £250,000 have to have their accounts independently examined. The Charity Commission has increasingly demanding expectations as to how charities should be managed and puts considerable resources into seeking to ensure that charities abide by these recommendations including operating a series of review visits to charities to check on governance and other issues. The charity's accounts are subject to considerable scrutiny on filing and questions may be raised about them.

Taxation of charities

The limitations imposed by charity law and regulation by the Charity Commission in England and Wales have to be weighed against the tax advantages accorded to charities. These are considerable, and are the reason that many social enterprises seek charitable status. The principle advantages are:

- 1) Tax relief on profits: The profits of any trade carried out by a charity are free of tax if the profits are applied solely to the purposes of the charity and the trade is exercised in the

course of the carrying out of the primary purpose of the charity;

- 2) Chargeable gains made by a charity, for example on disposal of a property, are tax free;

- 3) Charities do not pay tax on bank interest;

- 4) Charities do not pay stamp duty land tax.

Donations to charities are encouraged and attract tax relief. For example:

- 1) Legacies to charities are exempt from inheritance tax;

- 2) Gift to charities by companies and organisations which pay corporation tax are tax deductible as a charge on income;

- 3) Donations by individuals to charities attract Gift Aid relief. This means that, provided the individual is a UK taxpayer, the charity can recover the amount of the basic rate tax that the donor has paid on the amount of the gift;

- 4) Gifts to a charity of assets are free of capital gains tax and the charity can then sell them and realise the profit free of capital gains tax.

Rate relief for charities

Charities are entitled to a mandatory 80% relief from unified business rate in respect of any property which they occupy wholly or mainly for charitable purposes. The local authority has discretion to give a further 20% rate relief. In rating law, 'wholly or mainly' means a bit more than half.

Charities and trading companies

When a trading company is needed

Charities can only undertake a trade in fulfilment of their primary purpose, ie. what the charity is set up to do. Many charities wish to undertake further trading activities in order to raise money for the charity but which are not in fulfilment of the charity's primary purpose. If this is the case then the charity will have to set up a separate for-profit trading company owned by the charity. It is normal for such trading companies to be companies limited by shares although they can be companies limited by guarantee. This arrangement is approved by the Charity Commission and HM Revenue and Customs.

Charities can undertake a small amount of for-profit, non primary purpose trade through the charity. If they fall within the following exemptions they do not need to set up a trading company:

- 1) If the trade is ancillary to the primary purpose trade then this can be carried out through the charity. An example would be a cafeteria selling food and drink to museum visitors, where the museum is a charity.
- 2) If the trade is not wholly primary purpose trading, for example a theatre restaurant selling food and drink to theatre audiences (beneficiaries of the charity) but also to the general public, the charity can undertake this trade to a maximum of £50,000, provided the turnover of that part of the trade is less than 10% of the turnover of the whole trade.

3) If the trade is unrelated to a primary purpose trade, there is a small scale trading exemption which allows the charity to undertake the trade provided the turnover does not exceed £50,000 or 25% of the charity's gross income, whichever is the lesser.

4) If the trade is undertaken by the charity's beneficiaries, for example a restaurant run by disabled people who are beneficiaries of the charity, this can be undertaken within the charity as well.

Charities also establish trading companies to carry out primary purpose trades in order to isolate risk in a separate limited liability vehicle. In this case, the charity can support the trading company not just through the conventional financing methods detailed later in this chapter, but also through grants since the trading company is carrying out the charity's own purposes.

Before a charity can establish a trading company, it needs to satisfy itself that it has the appropriate investment powers in its constitution that allows it to do so. If it is an unincorporated charity then it will have such powers under the Trustee Act 2000. If it is a company limited by guarantee then it will almost certainly have such powers in its Memorandum of Association, but it should check.

Establishing a trading company

The trading company will normally be established as a company limited by shares with the charity as the sole shareholder. The amount

of money that the charity invests in the shares will depend on a number of factors, including the charity's assessment of the financing requirements of a subsidiary. The charity will need to resolve the precise relationship between the two entities and in particular, the structure of the trading company's board and management.

It is advisable to have some but not all of the trustees serving as directors of the trading company. The rest of the directors of the trading company can be drawn from the management of that company plus perhaps a non executive director or two with particular relevant expertise. It is not necessary for the chief executive of the charity to serve as director of the trading company, although it may be wise depending on the circumstances. It should also be borne in mind that the trustees of the charity cannot be paid for serving as directors of the trading company. This is based on the fundamental provision of charity law that a trustee should not benefit from his or her trust.

Charities with trading companies should be wary about setting up share ownership bonus schemes for employees of the trading company. The fundamental objective of the charity is to act for public benefit and an arrangement of this kind can lead to difficult conflicts of interest. Where staff are working for both organisations they may find their loyalties divided and perhaps pulled towards the trading company. This might for example lead to them advising the charity trustees to grant a loan to

the trading company at a low rate of interest with a result of an enhanced profit bonus or share valuation for staff members. If the trustees were to accept a low rate of interest this would lead to a breach of the Charity Commission's guidelines on loans (see the section below on financing trading companies). It can be difficult for volunteer trustees to spot all of these ramifications in a short meeting where they are understandably relying on a report prepared by the staff.

Charity law dictates that, while the trading company's staff or directors may advise the charity trustees, the charity's trustees must maintain an independent discretion.

Hiving off trading companies

Most trading companies are set up to have a long-term relationship with their parent company, to generate unrestricted funds for the charity which it can apply for its charitable purposes. However, in some cases a charity finds that it no longer needs the trading company and wishes to hive it off. This can be done, but can cause problems around the name of the trading company which may be bound up with the name of the charity. Much of the trading company's goodwill (and therefore value) is likely to be associated with the charity's brand.

If a charity sets up a trading company with a view to selling it off in the future, or decides after a while to consider selling the trading company, then it should seriously consider

Bryson Charitable Group

Company limited by guarantee with charitable status and trading subsidiaries



Business

Bryson Charitable Group is Northern Ireland's oldest community-based social services and environmental charity, with a wide-ranging remit to 'change people's lives'. It provides a wide range of services, from elderly care to kerbside recycling.

Reasons for choosing this legal form

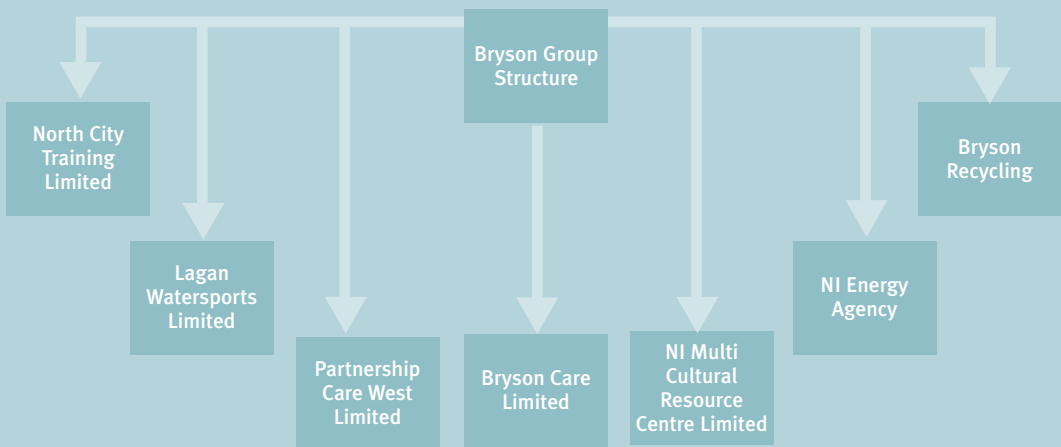
The original charity has been in existence for 100 years. As new services have been developed new subsidiary organisations have been added to the structure. These take a wide variety of forms (some are wholly-owned, some part-owned; some are charitable, some are not), depending on the particular circumstances surrounding that part of the business. The group structure allows the

Bryson Group to be flexible in choosing forms that best suit the particular service delivered by that subsidiary.

Bryson Charitable Group has entered into a number of joint ventures, most recently setting up Bryson Recycling Ltd with ECT Ltd. It has found that this arrangement allows the new company to learn from the substantial experience of the partners, while bringing local knowledge and influence to the business growth. This has made it easier to develop the business while strengthening its competitive position in the market place.

How it works

- Bryson House has a 'traditional' charitable structure, with an appointed board of trustees. It receives no core grant from government, with 77% of revenues derived from contracted services.



- The organisation has moved from being a 'traditional' charity chasing grant aid, to a more business-oriented model over a period of years. Senior management are recruited for their business and professional experience and non-executive board members are recruited to reflect community make-up and provide experience which can advise or assist executive officers.
- The organisation does not directly recruit service users to the board of trustees. However, through its commitment to continuous improvement and its group wide 'Journey to Excellence' quality assurance programme it proactively facilitates a number of stakeholder groups and feedback processes that allow stakeholders and service users to have a say and influence service developments to better meet their needs.

Key points

Setting up trading subsidiaries gives the organisation flexibility to tailor the organisation of each subsidiary to the particular service they are delivering.

Joint ventures can allow the organisation to benefit from synergies provided through both partners' expertise.

The organisation uses a variety of ways to involve different stakeholder groups, from consultation meetings to involvement as a trustee. This allows different people to contribute at a level they are comfortable with.

This model of development avoids the negative effects of being grant-aid dependent while providing substantial autonomy in respect of service development options.

Contact: www.brysonhouse.co.uk/contact.htm
Website: www.brysonhouse.co.uk

developing a parallel brand under which the trading company can start to trade. As the new brand becomes better known, the charity brand can be given less exposure until the trading company only trades under the new brand. At that point much of its value and goodwill will attach to the new brand and the company can be sold for a much higher value than if it were to be sold off with the business stripped of the right to use the charity's brand.

Financing trading companies

In deciding to finance a trading company, charity trustees have to comply with their duty of care. Under the Trustee Act 2000, a trustee of an unincorporated charity is subject to a standard duty of care, which obliges him or her to exercise such care and skill as is reasonable in the circumstances, having regard to any special knowledge or experience he or she has. In the case of incorporated charities, the trustees are under a similar duty. In particular, trustees have to avoid investments of a hazardous or speculative nature.

Often investing in a charity's own trading company is likely to be a far riskier investment than putting the money into more conventional forms of investment. However, in assessing any proposal to invest in a trading company, trustees may well be able to take into account the fact that the trading company is achieving a mixture of financial and charitable objectives. It may well be that some of the trading company's activities do fulfil the charity's objects. If this is the case then the charity does

not need to expect a financial return on that part of the trading company's activities that fulfils its charitable purposes. For example, if a trading company undertakes 60% pure commercial activities and 40% activities in fulfilment of the charity's own objects, the charity only needs to seek a reasonable financial return on 60% of its investment, provided that this split continues and is likely to do so in the foreseeable future. Obviously the trustees will have to keep the ratio between charitable and non-charitable activities in the trading company under review.

If trustees decide to invest then they should be provided with sufficiently detailed information to allow them to make a sound and proper decision. Such information may well include:

- Market research (unless it is a question of a charity hiving off to the trading company a business which it has already built up)
- A budget showing projected capital and ongoing expenditure and income
- A cashflow forecast for at least two years
- A business plan showing how it proposes to develop
- An analysis of working capital requirements.

The trustees should consider this information carefully and in detail, mindful of the need to comply with their various legal duties. The minutes of the meeting should record any resolution to invest in a trading company and should refer to the documents upon which the

trustees have relied in reaching that decision.

The Charity Commission accepts that charities will finance trading companies by way of loans. From the charity's point of view a loan with security is less hazardous than investment in share capital because if the trading company goes into insolvent liquidation, the secured creditors are paid out before the unsecured creditors and the shareholders. The Charity Commission recommends that where a charity lends money to a trading company it should:

- 1) Charge a proper rate of interest: the loan should not be interest-free unless the trading company is fulfilling the charity's objects. It will be normal to charge a rate that is higher than the charity would get if it were to deposit the funds with its bank
- 2) Take security for the loan: the charity should take a fixed and floating charge over all the assets of the trading company to secure the loan. This is of course subject to the assumption that no charge has been given to any other party, for example a bank. Care needs to be taken in respect of floating charges over book debts
- 3) Lay down terms for repayment of the loan: it is most sensible either to make the loan repayable after a period of a year or on demand. The Charity Commission's preference is to state a schedule of repayments.

Before making a loan to a trading company, charity trustees also have to consider

whether or not the loan constitutes 'qualifying

expenditure' for the purposes of Section 505(3) of the Taxes Act 1988. That section, together with Section 506, contains curbs on charities which have tax-free income of over £10,000 in a 12-month period. If a charity incurs 'non-qualifying expenditure' the charity will lose tax relief (and hence pay tax) on the amount equal to its non-qualifying expenditure in the period. Non-qualifying expenditure includes 'non-qualifying loans'.

A 'qualifying loan' is defined as:

- A loan made to another charity for charitable purposes only;
- A loan made to a beneficiary of a charity;
- Money placed on current account with a recognised banking institution;
- Any other loan which the Inland Revenue is satisfied is made for the benefit of the charity and not for the avoidance of tax.

A loan to a trading company would only fall in the last category. By and large HM Revenue and Customs accept that if a charity has complied with the Charity Commission's guidelines on making loans, then it will accept the loan was a qualifying loan. This applies whether the charity is registered with the Charity Commission or not.

The charity should not subsidise a trading company, but should have an arm's length relationship from it. That means that the charity should charge the trading company for its use of the charity's staff, premises etc. The charge should be based on a costs recovery

basis only. The charity should not make a profit from operating the charge, as it might pay tax on the surplus because it is not derived from primary purpose trading. The arrangement should be set out in an agreement which should also cover the use of the charity's name, data (if applicable and if compliant with the Data Protection Act 1998), intellectual property and other matters. If the charity and the trading company are part of the same VAT group, the charge will not attract VAT. If they are not part of the same VAT group it will attract VAT if the charity is registered for VAT or has to register as a result of making the supplies to the trading company.

Trading company profits

It is normal for the trading company to give away all its profits to the charity under Gift Aid. This means that the trading company does not pay any corporation tax on its profits and the charity receives them tax free.

The disadvantage with stripping out the profits each year, advantageous though this may be from a taxation point of view, is that the trading company does not build up any reserves or working capital. It is therefore dependent on the charity lending money back immediately after receiving it. The payment and the Gift Aid must be made by a cash payment and not done merely by an inter-company book adjustment, and must be made within nine months of the end of the trading company's financial year if it is wholly owned by the charity. If it is not, the Gift Aid payment

must be made within the trading company's relevant financial year to be tax deductible in that year.

How social enterprises can obtain funding from charities

GRANTS OR DONATIONS

Many social enterprises are charities and therefore it is perfectly possible for grant making trusts or other charities to support them by grants or donations provided the donor has charitable objects that are identical to or similar to those of the charitable social enterprise.

Charities can also support social enterprises that are not charities where they are carrying out work that furthers the charitable purposes of the donor. However, they would have to ensure that the donation was ring-fenced for those particular purposes. For example, a charity with education objects could give a grant to a non-charitable social enterprise that was running an education programme for disadvantaged children.

SOCIAL INVESTMENT

Grant making trusts can also lend money to social enterprises, not so as to obtain a purely financial return, but as a form of social investment. As such, the grant making trust can make this loan at either a lower or nil rate of interest and perhaps a longer period of capital repayment.

In some cases charitable social enterprises are established as companies limited by shares. In this case it is possible for other charities to purchase shares in the capital of the charitable social enterprise.

As with donations, it is possible for charities to support non-charities where they are carrying out the charitable purposes of the charity. Hence if a social enterprise is working with unemployed people and developing their skills, it is perfectly possible for a charity to put together a social investment programme for that social enterprise. This could include:

- A loan at a lower rate of interest;
- Possibly the purchase of shares in the company (if it is a company).

In either case the charity will need to have an exit strategy which allows it to demand its money back if the non-charity starts to change its business and moves its market so that it is no longer fulfilling a public or charitable purpose but a private one for the benefit of its staff and investors. Alternatively a social enterprise might be achieving a mix of charitable and non-charitable goals and a charity may be prepared to lend it money on the basis that it only expects an appropriate return on the investment in so far as that is supporting the non-charitable activities and it accepts a nil or low rate of return from the money that goes towards supporting the charitable activities. Again the charity will need to think about exit strategies.



useful information

- Glossary
- Solicitors specialising in social enterprise
- Key contacts

Glossary

AGM: see **Annual General Meeting**.

Annual General Meeting an annual meeting of the members.

Articles of Association: one of the two governing documents of the company, it sets out rules on governance.

Asset a useful or valuable possession of an organisation.

Board: the group of individuals entrusted with day to day responsibility for the organisation.

Board of management: see **Board**.

Board of trustees: see **Board**.

CDFI: Community Development Finance Institution – a lender specialising in lending to social enterprises.

CIC: community interest company.

CLG: company limited by guarantee.

CLS: company limited by shares.

Chair: an individual who Chairs a meeting.

Community benefit society: a type of industrial and provident society.

Company secretary: the individual responsible for a company's administration.

Constitution: the governing document of an organisation.

Co-operative: an organisation with a democratic structure which operates for the benefit of its members.

Directors: the individuals entrusted with day to day responsibility for the organisation.

EGM: see **Extraordinary General Meeting**.

Equity finance: raising money by selling shares.

Extraordinary General Meeting: a meeting of the members which is held as and when needed.

Federation: a structure whereby a number of different organisations work together.

Fixed charge: form of security which is fixed on a particular asset.

Floating charge: a form of security which only fixes on particular assets when it is enforced.

FSMA: Financial Services and Markets Act.

Group structure: a structure whereby one organisation has a number of subsidiaries.

Incorporated legal form: a legal form which is a separate legal entity.

IPS: industrial and provident society.

Liability: legal responsibility of an organisation.

Listed company: a company whose shares may be bought or sold on a stock exchange.

LLP: limited liability partnership.

Management committee: See **Board**.

Mem and Arts: see **Memorandum of Association and Articles of Association**.

Memorandum of Association: one of two governing documents of a company, setting out its main features.

Partnership: a legal form created when two or more persons come together with a view to a profit.

Qualifying expenditure: expenditure which qualifies as such for tax purposes.

Risk capital: the shares in a company.

Share capital: the shares in a company.

Shares: the units into which ownership of a company is split.

Society: see **IPS**.

Sole trader: an individual in business alone.

Special resolution: a resolution passed by 75% of members at a meeting of which the requested notice has been given.

stakeholders: individuals and organisations interested in the organisation.

Trading company: a company which is usually a subsidiary of a charity.

Treasurer: individual with responsibility for an organisation's finances.

Trustees: individuals with day to day management of an organisation.

Unincorporated: legal form which is not a separate legal entity from its members.

Solicitors specialising in social enterprise

Bates, Wells & Braithwaite

2-6 Cannon Street
London EC4M 6YH
Tel: 020 7551 7777
www.bateswells.co.uk

Cobbetts Solicitors

Ship Canal House
King Street
Manchester M2 4WB
Tel: 0845 404 2404
www.cobbetts.co.uk

Hempsons Solicitors

Hempsons House
40 Villiers Street
London WC2N 6NJ
Tel: 020 7839 0278
www.hempsons.co.uk

Wrigleys Solicitors

19 Cookridge Street
Leeds
West Yorkshire LS2 3AG
Tel: 0113 244 6100
www.wrigleys.co.uk

Key contacts

4 Children

City Reach
5 Greenwich View Place
London E14 9NN
Tel: 020 7512 2112
www.4children.org.uk

ACEVO

1 New Oxford Street
London
WC1A 1NV
www.acevo.org.uk

ACRE

Somerford Court
Somerford Road
Cirencester
Gloucestershire GL7 1TW
Tel: 01285 653 477
www.acre.org.uk

Association of British Credit Unions (ABCUL)

Holyoake House
Hanover Street
Manchester
Lancashire M60 0AS
Tel: 0161 832 3694
www.abcul.org

Barclays Bank

[www.barclays.com/responsibility/
select](http://www.barclays.com/responsibility/select) - Contact Us

Baxi Partnership Ltd

Evans Business Centre
Pitreavie Business Park
Dunfermline
Fife KY11 8UU
Tel: 01383 749670
www.baxipartnership.co.uk

Buzzacott

12 New Fetter Lane
London EC4A 1AG
Tel: 0207 556 1200
www.buzzacott.co.uk

The Co-operative Group

New Century House
Manchester
Lancashire M60 4ES
Tel: 0161 834 1212
www.co-op.co.uk

The Charity Bank Limited

PO Box 398
194 High Street
Tonbridge
Kent TN9 9BD
Tel: 01732 774040
www.charitybank.org

Community Action Network

1st Floor
Downstream Building
1 London Bridge
London SE1 9BG
Tel: 0845 456 2537
www.can-online.org.uk

Community Transport Association

Highbank
Halton Street
Hyde
Cheshire SK14 2NY
Tel: 0870 774 3586
Advice Service Tel: 0845 130 6195
www.communitytransport.com

Confederation of Co-operative Housing

Fairgate House
205 Kings Road
Tyseley
Birmingham B11 2AA
Tel: 0121 449 9588
info@cch.coop

Co-operatives UK

Holyoake House
Hanover Street
Manchester M60 0AS
Tel: 0161 246 2900
www.cooperatives-uk.coop

Department of Trade & Industry

Response Centre, 1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000
www.dti.gov.uk

Development Trusts Association

33 Corsham Street
London N1 6DR
Tel: 0845 458 8336
www.dta.org.uk

Employee Ownership Scotland

Robert Owen House
87 Bath Street
Glasgow G2 2EE
Tel: 0141 554 3797

Enterprise Insight

6 Mercer Street
Covent Garden
London
WC2H 9QA
Tel: 020 7497 4030
www.starttalkingideas.org

Financial Services Authority (FSA)

25 The North Colonnade
Canary Wharf
London E14 5HS
Tel: 020 7676 1000
www.fsa.gov.uk

International Co-operative Alliance

15, Route des Morillons
1218 Grand-Saconnex, Geneva, Switzerland
Tel: (+41) 022 929 88 88
www.ica.coop/ica/

Job Ownership

2nd Floor
Downstream Building
1 London Bridge
London SE1 9BG
Tel: 020 7022 1960
www.jobownership.co.uk

Local Government Association

Local Government House
Smith Square
London SW1P 3HZ
Tel: 020 7664 3000
www.lga.gov.uk

Local Investment Fund

7th Floor
Ibex House
42-47 Minories
London EC3N 1DY
Tel: 020 7680 1028
www.lif.org.uk

Lloyds TSB Bank plc

Tel: 0845 3 000 000
www.lloydstsb.com

Mutuo

77 Weston Street
London SE1 3SD
Tel: 020 7367 417
www.mutuo.co.uk

**National Council of Voluntary Organisations
(NCVO)**

Regent's Wharf
8 All Saints Street
London N1 9RL
Tel: 020 7713 6161
www.ncvo-vol.org.uk

National Housing Federation

Lion Court
25 Procter Street
London WC1V 6NY
Tel: 020 7067 1010
www.housing.org.uk

Natwest & Royal Bank of Scotland

Community Development Banking
Level 3
2 Waterhouse Square
138 – 142 Holborn
London EC1N 2TH
Tel: 020 7427 9139
www.natwest.co.uk

New Economics Foundation (NEF)

3 Jonathan Street
London, SE11 5NH
Tel: 020 7820 6300
www.neweconomics.org

North East Social Enterprise Partnerships

Wyvestow Lodge
2 Sunderland Road
South Shields
Tyne & Wear NE33 4UR
Tel: 0191 4567947
www.nesep.co.uk

Office of the Third Sector

General enquiries
Cabinet Office
70 Whitehall
London SW1A 2AS
Switchboard: 020 7276 1234
www.cabinetoffice.gov.uk

Regional Development Agencies

www.consumer.gov.uk/rda/info/

Regional Government Offices

www.government-offices.gov.uk

RISE

Unit 1
Cranmere Court
Lustleigh Close
Matford Business Park
Exeter EX2 8PW
Tel: 01392 473465
www.rise-sw.co.uk

Scottish Social Enterprise Coalition

45-47 Albany Street
Edinburgh
EH1 3QY
Tel: 0131 557 1516
Telephone 0131 557 1516
www.ssec.org.uk

Skoll Centre for Social Entrepreneurship

Saïd Business School
University of Oxford
1 Park End Street
Oxford, OX1 1HP
Tel: 01865 288 838
www.sbs.ox.ac.uk

Small Business Service

Department of Trade and Industry
1 Victoria Street, London SW1H 0ET
Tel: 020 7215 5000
www.sbs.gov.uk

Social Economy Network for Northern Ireland

Contact: Audrey Murray
Tel 028 28269973
www.socialeconomynetwork.org

Social Economy Network (Wales)

Llandaff Court, Fairwater Road
Cardiff, CF5 2XP
Tel: 029 2055 4955
www.walescoop.com

Social Enterprise Coalition (UK)

Southbank House, Black Prince Road
London SE1 7SJ
Tel: 020 7793 2323
www.socialenterprise.org.uk

Social Enterprise East of England

Unit 8
Chesterton Mill
French's Road
Cambridge CB4 3NP
Tel: 01223 305 363
www.seee.co.uk

Social Enterprise East Midlands

Foxhall Business Centre
Foxhall Road
Nottingham NG7 6LH
Te: 0115 845 6434
www.seem.uk.net

Social Enterprise London

3rd Floor, Downstream Building
1 London Bridge
London SE1 9BG
Tel: 020 7022 1920
www.sel.org.uk

Social Enterprise magazine

Tel: 020 8442 1623
www.socialenterprisemag.co.uk

**Social Enterprise Network for Scotland
(SENSCOT)**

54 Manor Place
Edinburgh EH3 7EH
Tel: 0131 220 4101
www.senscot.net

**Social Enterprise Unit
Department of Trade & Industry**

1 Victoria Street
London SW1H 0ET
Tel: 020 7215 0293

Social Firms UK

1st Floor
Furness House
53 Brighton Road
Redhill
Surrey, RH1 6PZ
Tel: 01737 764021
www.socialfirms.co.uk

SpoRTA

Greenwich Leisure Ltd
Middlegate House,
1 Seymour Street
The Royal Arsenal
London SE18 6
Tel: 07834 780 035
mikemccardle@sporta.org
www.sporta.org

Supporters Direct

3rd Floor
Victoria House
Bloomsbury Square
London, WC1B 4SE
Tel: 0870 1600 123
www.supporters-direct.org

Triodos Bank

Brunel House
11 The Promenade
Clifton
Bristol
Avon BS8 3NN
Tel: 0117 973 9339
www.triodos.co.uk

**Wales Co-operative Development & Training
Centre**

Llandaff Court
Fairwater Road
Cardiff CF5 2XP
Tel: 029 2055 4955
www.walescoop.com

Unity Trust Bank plc

Nine Brindleyplace
Birmingham B1 2HB
General Enquiries
0845 140 1000
Trade Unions & Credit Unions
0845 11 777 66
Charity & Voluntary Orgs
0845 11 777 22

