

Fact Sheets

The following fact sheets provide more detailed information on subjects discussed earlier in the guide. They are intended for use by the facilitator and participants as an easy to use overview of the following issues:

Commonly Used Legal Forms

1. Unincorporated Organisations: Trusts, Associations and Partnerships.
2. Companies Limited by Guarantee
3. Industrial and Provident Society (Co-operative)
4. Industrial and Provident Society (For the benefit of the community)

Organisational Factors

5. What is a Co-operative?
6. Charitable Status

Fact Sheet I

Unincorporated Organisations

What is an Unincorporated Organisation?

An unincorporated organisation is 'a group of people bound together by common purposes, which has rules to identify whom controls it and with whom funds rest, and which members can join or leave voluntarily³.

Unincorporated organisations have no legal identity separate from their members and, because of this, all property, contracts and leases required by the business must be owned by one or more of the members as individuals. As such members carry personal liability for the organisation's debts and the liability of members is unlimited.

However, unincorporated organisations can be cheaper to run than incorporated companies. Unincorporated organisations do not need to submit audited accounts and in general have a more simplified constitution (when compared to incorporated organisations).

This fact sheet presents an overview of three kinds of unincorporated organisations: **Trusts**, **Associations** and **Partnerships**.

Trusts

Key features of trusts are listed below:

- Trusts exist as custodians of assets, funds or property. Their purpose is detailed in their *Trust Deed*.
- Trusts can be as simple or complex as necessary.
- *Trustees* manage a trust, acting as custodians for those for whom it has been established according to the instructions in the *Trust Deed*.
- All assets owned by the trust must be used for the benefit of its intended beneficiaries.
- Trustees often appoint their own successors, which enables them to safeguard the overall direction of the trust's activities.

Strengths	Weaknesses
<ul style="list-style-type: none">● Trust are cheap to establish● Unless it is a charity, a trust is not regulated by any statutory body● No annual reports or submissions are required, unless it is charitable● Trustee's deliberations can be held in private● A trust requires only two people	<ul style="list-style-type: none">● Trustees have personal liability for the unlimited debts of the trust● Altering trust deeds can be complicated● Trusts can appear accountable only to themselves● It is difficult to remove trustees● The fact that trustees must personally hold assets or property makes transfer of ownership hard

³ Conservative and Unionist Central Office v. Burrell, 1982)

Associations

Key features of associations are listed below:

- An association is formed when a group of people come together for an agreed purpose to benefit themselves or others, as long as that purpose is not to make a profit.
- All profits must be used to further the objectives of the association and not transferred to members.
- An association requires two or more individuals and is often governed by a written constitution.
- Unless the rules state otherwise, all members must agree to a new member joining.
- Property is technically in the hands of individual members, and remains in their hands until it is explicitly transferred, unless it is specifically vested in custodian trustees.
- There is no implied power for an unincorporated association to borrow.
- If the rules do not state that the management committee is the employer, then whoever confirmed the appointment is the employer and is personally liable, even if they are no longer a member of the association.
- An unincorporated association may dissolve spontaneously, or else the agreement of all members is needed.
- Associations tend to be most appropriate for temporary, specific and local purposes.

Strengths	Weaknesses
<ul style="list-style-type: none"> ● Associations are easy to establish ● Associations are flexible ● Unless it is a charity, an association is not regulated by any statutory body. ● Associations can involve as many or as few individuals or groups as is required. 	<ul style="list-style-type: none"> ● Not being a legal entity, an association cannot enter into contracts itself and therefore cannot employ staff

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Organisational Structures for Rural Social Enterprises

Partnerships

Key features of partnerships are listed below:

- Partnerships exist as simple unincorporated bodies, which are easy to establish and formed when two or more people go into business together to earn and share the proceeds.
- Partners are jointly and severally responsible for the debts of the partnership.
- A partner's personal assets can be seized to settle the partnership's debts.
- Each partner can make decisions and enter contracts without prior approval of other partners.
- The death of a partner may lead to the automatic dissolution of the partnership.

Legal and Financial Issues in Forming a Partnership

- Usually between two and twenty partners (professional partnerships are an exception)
- If a Deed of Partnership is not prepared, partnerships are governed by the Partnership Act 1890.
- Each partner is registered as being self-employed.
- Each partner is taxed on their share of the overall profit.
- Partners pay National Insurance contributions (Class 2 and 4).
- Partnerships are liable for VAT and Capital gains tax, if relevant.

Deeds of Partnership

Although a partnership can be created without a Deed of Partnership and governed by the Partnership Act (under which profits are shared equally regardless of investment or input), it is more common for a Deed to be drawn up. In doing so partners are able to decide how profits will be allocated. Deeds will often detail:

- How profits will be shared.
- How work will be allocated and divided.
- The responsibilities for managing the partnership.
- The amount of capital invested and, if applicable, the rate of return to be provided on it.
- Ceilings for purchasing, and at what level the agreement of other partner(s) is needed to authorise expenditure.

Strengths	Weaknesses
<ul style="list-style-type: none">● Partnerships are easy to establish.	<ul style="list-style-type: none">● Unlimited liability for decisions taken by other partners over which one has no control (excluding ceilings for purchases if specified in the deed)
<ul style="list-style-type: none">● Complementary skills of partners are brought together.	<ul style="list-style-type: none">● Capital accumulation is not easy
<ul style="list-style-type: none">● No formal "Annual Return" is required.	<ul style="list-style-type: none">● Difficulties if a partner wishes to leave

Strengths	Weaknesses
<ul style="list-style-type: none"> ● Shared management risks, responsibilities and losses. ● Ability to attract limited partners (i.e. investors) ● Little regulation to deal with. 	<ul style="list-style-type: none"> ● Lack of continuity ● Potential for personality and authority conflicts ● Partners are bound by agreements of others. ● Sustainability: On the death or departure of one partner the partnership must be dissolved.

Partnerships and Village Shops

While partnerships are not commonly used as a structure for social enterprises, a partnership can be considered as an option for the operation of a community-owned village shop.

In this scenario, the community could form a partnership with the shopkeeper, issuing shares or debentures to raise funds to purchase part of the business. The shopkeeper would then pay the partnership an annual fee which would be used to repay the debentures over a period of time. ViRSA recommend that this is an effective way in which the village may retain control over the property.

Fact Sheet 2

Company Limited by Guarantee

What is a Company Limited By Guarantee (CLG)?

As an incorporated body, a Company Limited by Guarantee enables members and owners to minimise their liabilities through the creation of a separate legal entity.

A Company Limited by Guarantee (CLG) differs from the more common Company Limited by Shares in that it does not have shareholders. Instead, its members merely guarantee a (usually nominal) contribution to its assets should it become insolvent. This is a commonly used legal form for social enterprises and not-for-profit organisations because it is flexible and easily understood by lawyers and accountants. Research on social enterprises shows that CLGs are by far the most popular legal model.

Basic Principles of a Company Limited By Guarantee.

- When a new CLG is formed, membership is offered by invitation only, they are not offered to the general public.
- Membership in a CLG cannot be publicly traded (for example on the stock market). Membership is therefore often held by those with an interest in the company, for example other businesses, employees or acquaintances
- In a CLG members are liable up to the value of guarantee they have agreed to. This is normally a nominal amount, for example £1. In some circumstances, however, banks or other creditors may require directors to provide some form of additional personal guarantee to secure loans.
- Capital for CLGs is normally raised through debt issue, loans, grants or donations. Unlike Plcs, a CLG cannot raise new capital by issuing more shares.
- CLGs can include a clause in their constitution stating that if it is wound up its assets may only be passed on to other organisations, often specified as organisations with similar aims. This prevents assets from being distributed for personal gain.

Legal and Financial Issues in Forming a Company Limited by Guarantee

- Companies Limited by Guarantee are governed by legislation including, but not limited to, the Companies Act.
- A CLG can comprise of a single member (Director) but in addition to the single Director there must be a different person acting as company secretary.
- Most people are permitted to become a company director. However age limits apply. In general, people under the age of 18 cannot be directors and, unless the Articles specify otherwise, people over the age of 70 cannot be directors. In addition people can also be barred due to legal disqualification or for being an undischarged bankrupt.

- The company must submit an “annual return” to the Registrar of Companies with basic information.
- Companies must also submit audited accounts to Companies house.
- Companies House must be kept informed and up to date on changes of company officers and their addresses.
- Income Tax and National Insurance contributions are payable for directors and employees.
- Corporation Tax is payable on profits. Companies are now required to conduct a self-assessment for corporate tax. The company’s corporate tax return is due 12 months after the end of its financial year and must be paid within 9 months and one day from the end of the financial year.

Process for Establishing a Company Limited by Guarantee

- Registration of a CLG is simple and relatively cheap.
- An ‘off-the-shelf’ company can be bought to enable trading to begin almost immediately. By purchasing a “ready made” company, its details can be amended to match your company. With notification of the Registrar, a legal entity is quickly established with minimum administrative requirements. Company Registration Agents and some solicitors sell such companies.
- However, most social enterprises will choose to register a new company with model structures developed by a specialist sponsoring organisation, such as Co-operativesUK.
- Documents must be filed with the Registrar of Companies. These include the Memorandum of Association and Articles of Association.

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Organisational Structures for Rural Social Enterprises

Summary: *Companies Limited by Guarantee*

	Strengths	Weaknesses
Cost and Ease of Establishment	<p>Low cost of formation.</p> <p>Easy and quick to set up, off the shelf companies can be bought and used.</p> <p>Can be started with only one member (but need to have a separate company secretary).</p> <p>Little capital required at start.</p>	
Administrative Costs and Requirements	<p>Registration costs:</p> <ul style="list-style-type: none"> • £20 for registration within 5-7 days. • £80 for registration with 24 hours. • Solicitors fees. • £30 for Memorandum and Articles of Association. <p>Annual Returns</p> <ul style="list-style-type: none"> • £15 annual fee 	<p>Companies must submit a set of audited accounts</p> <p>Strict adherence to regulations requiring annual returns is essential. Fines are charged if the rules are not observed.</p>
Constitutional Limitation	<p>CLG is highly flexible. A broad range of constitutional arrangements can be adopted, including co-operative-type constitutions.</p>	
Regulatory Environment	<p>Regulations are kept up to date and relevant.</p>	<p>Wide body of continually changing legislation must be adhered to.</p> <p>In, general regulations for Companies are designed to serve investor driven enterprises and are not designed with social enterprises in mind.</p>
Investment and Financial Implications.	<p>Limited liability can encourage investors.</p> <p>Ability to raise finance through loans etc offers opportunity for growth without involving external shareholders and control.</p>	<p>Capital cannot be raised through share issues. Speculative capital investment is not an option.</p> <p>Banks often don't like lending to CLGs because they usually have limited assets.</p>
Tax, NI and Pensions	<p>Surpluses can be covenanted to community charitable trusts in a tax efficient way.</p>	<p>Full tax, NI contributions and corporate rates apply unless charitable status obtained.</p>
Governance / Management	<p>Company is "controlled", as much as owned by members, who appoint directors to govern the enterprise.</p> <p>Directors can be paid.</p> <p>Since members and board need to be invited to join the CLG it is relatively easy for the company to maintain its objectives and mission.</p>	<p>Since the board and membership are often the same there is risk of potential mis-management and lack of transparency. However this is a challenge faced by many other forms of enterprise such as IPS's and associations.</p>
Change and Sustainability	<p>Enables enterprise to continue if one or more members leave.</p>	<p>Unless "locked" (i.e. by a golden guarantee)) future members can amend constitution and benefit from assets inherited.</p>

	Strengths	Weaknesses
Implications for Business Strategy	People and other organisations are more likely to participate in a limited company due to its limited liability.	Company accounts are publicly available, this exposes the enterprise to potential scrutiny by competitors.
Identity		People can view a company structure as being synonymous with a profit orientation.

Fact Sheet 3

Industrial and Provident Society Co-operative

What is an Industrial and Provident Society Co-operative?

Two forms of Industrial and Provident Society (I&PS) exist, a *bona-fide co-operative* and a *society for the benefit of the community*. This section deals with the former, referred to here as an I&PS Co-operative.

Since December 2001, I&PS Societies are regulated by the Financial Services Authority. The FSA regulates 9,500 registered I&P Societies in England and Wales with 9.5m members and total assets of £56b in 1999⁴.

An Industrial and Provident Society is a corporate body registered under the Industrial and Provident Societies Acts 1965-1978. To be registered as an I&PS an organisation should carry out “*an industry, business or trade, whether retail or wholesale*”.⁵ An I&PS Co-operative must conduct these activities as one of its primary objects.

An I&PS Co-operative is a corporate form used by a broad range of enterprises: agricultural and worker co-operatives, retail co-operatives, credit unions and housing co-operatives. An I&PS Co-operative will typically observe the international co-operative principles (see Fact Sheet 5). Instead of a Memorandum and Articles of Association, as required by Company Law, I&P Societies are governed by their ‘Rules’.

Co-operatives^{UK} consider that the legal framework regulating I&P Societies is generally more sympathetic to social benefit and co-operative organisations in that the administrative and statutory requirements are more lenient. They also note that the I&PS Act places greater trust in directors acting “in good faith” and is less complex and punitive than Companies Act legislation.

Basic Principles of an I&PS Co-operative

The FSA demands that an I&PS Co-operative satisfy the following conditions, which are broadly comparable with the ICA co-operative principles (see Fact Sheet 6)

- *Community of Interest*: There should be a common economic, social or cultural need and / or interest amongst all of its members.
- *Conduct of Business*: The business should be run for the mutual benefit of members, so that the members’ benefit will stem principally from their participation in the business.
- *Control*: Control is exercised equally by all members and should, in general, be on a ‘one-member, one-vote’ basis. Officers of the Society should normally be elected by members.

⁴ Charity Finance, 2002, p.22
⁵ ICOM, 1994, p.29.

- *Interest on Share and Loan Capital.* Members should receive only limited compensation for any loan or share capital invested in the enterprise; interest rates can only be at a level required to obtain sufficient capital to conduct the operations of the enterprise. It may not carry on business to earn a profit mainly for the payment of interest, dividends or bonuses.
- *Profits:* Can be distributed if allowed in the rules with each member receiving an amount that reflects their participation with the Society.
- *Restriction on Membership:* Membership should normally be open. There should be no artificial restrictions on membership to increase the value of the rights or interests of current members.
- There must be *at least three members*, unless it is composed of two registered societies.

Legal and Financial Issues

- Unlike limited companies, there is no such structure as an 'I&PS limited by guarantee'. It is possible however to stipulate that a single share will be issued to each member at a nominal value and will realise no dividends or interests. This is how many I&P Community Benefit Societies are structured.
- Co-operativesUK consider that this model is often suited for a community business, permitting members of the community to invest in the enterprise without distorting its democratic control and with at least a reasonable expectation that they will be able to withdraw their investment if required.
- An I&PS issues shares. Shares within an I&PS are, however, different from those in normal companies.
 - I&PS shares are redeemable, subject to the rules of the Society.
 - I&PS shares are usually issued at a fixed value. As a result shares are worth the same amount they were purchased for when they are redeemed, there is no capital growth.
- Return on capital raised through loans or shares must be limited to the rate necessary to raise and retain sufficient capital to the enterprise's activities.
- Raising capital for further continued enterprise development is a fundamental challenge for I&P Societies. While having the advantage of being able to raise capital by issuing shares to members, issuance of shares to raise capital from non-members is not allowable.
- Debentures are often issued as a method of raising capital. A debenture is a type of bond entitling the owner to periodic capital and interest, that has no assets pledged as security. Debenture holders are therefore considered as unsecured creditors
- An I&P Society is subject to Corporation Tax.
- Under I&PS legislation if a Society is wound up while solvent, its residual assets can be redistributed to members for personal profit. This act, which can be considered to be contrary to International Co-operative Principles, raises the possibility that members seek to wind up a Society to realise the value of its assets. As such an I&P Society must clearly decided whether this is an acceptable event, and if not, decide how to structure itself to deny members the possibility of doing so.

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- Legislation currently restricts individual shareholdings to a maximum of £20,000 per member.
- Voting rights are not attached to shareholding. Instead voting is performed on a one member one vote basis.
- Registration as an I&PS is cheaper, easier and faster if performed through a sponsoring body using model rules.
- The strict control of I&P Societies by the FSA includes their ability to refuse any changes to the Rules that they consider are in breach of the spirit of the Society. Whilst this can be considered to reduce the independence and decision making autonomy of the Society, it does offer an 'independent' monitor who will help safeguard the Society's objectives and mission.
- If its objectives or activities are charitable, (as defined by the Charity Commission), an I&PS may receive 'exempt charity' status from the Inland Revenue and receive the tax benefits of charitable status. It may not however register separately with the Charity Commission and cannot not receive a charity registration number or become a charity under any circumstances. This can deter some donors from contributing to an I&PS, however charitable / grant funding is possible

Summary: Industrial and Provident Societies

	Strengths	Weaknesses
Cost and Ease of Establishment	<p>Medium/high cost of formation. £240.</p> <p>Takes longer time establish than a company: 1-2 weeks minimum.</p> <p>Requires minimum of 3 members.</p>	<p>Easiest and cheapest form of registration requires a sponsor (e.g. Co-operativesUK.)</p>
Administrative Costs and Requirements	<p><i>Registration Costs</i>⁶:</p> <ul style="list-style-type: none"> ● £100 using model rules and no changes. ● £120 using model rules and 1-6 changes. ● £350 using model rules and 7-10 changes. ● £950 using model rules and 11+ changes or freely drafted rules. <p>Annual Fee: (based on size of assets)</p> <ul style="list-style-type: none"> ● £0-50K: £60 ● £50-100K: £100 ● £100-250K: £150 ● £250K-£1m: £200 ● £1m+: £370 	<p>Annual return must be submitted to the FSA. FSA must be informed of any change of address, name or rules.</p> <p>Membership records have to be maintained.</p>
Constitutional Limitation	<p>The 'rules' of an I&PS are usually straightforward and easy for members to understand.</p> <p>Difficulty in changing rules and requirement of FSA approval helps safeguard objectives and assets from being 'hi-jacked' by members for personal benefit.</p>	<p>Changing rules requires approval of FSA and can be time consuming.</p>
Regulatory Environment	<p>Regulations do not change frequently and are relatively simple.</p>	<p>Regulations are somewhat old but are designed specifically with the needs of social enterprises in mind</p>
Investment and Financial Implications.	<p>Qualification loans from members.</p> <p>Dividends paid on loans.</p> <p>Charitable / grant funding possible</p>	<p>Capital can only be raised through share issues to members.</p> <p>Speculative investment is not an option.</p>
Tax, NI and Pensions	<p>If mutual tax status granted, dividends are paid before tax.</p> <p>Tax benefits if charitable status granted.</p>	<p>Full tax, NI contributions and corporate rates apply unless charitable status obtained.</p> <p>No charitable number available which deters some donors and support.</p>
Governance / Management	<p>Community / member ownership and control.</p>	<p>Community / member ownership and control.</p>
Change and Sustainability	<p>Society continues if members die or leave.</p>	<p>Changes to rules can be hard to achieve and slow. FSA must check all changes.</p>
Implications for Business Strategy	<p>Allows producers to realise economies of scale and therefore improve bargaining power with suppliers and purchasers.</p>	<p>Not recommended for capital intensive projects.</p>

² Indicative figures as of September 2002

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	Strengths	Weaknesses
Implications for Business Strategy (cont)	<p>Enables producers to use shared resources to increase “added value” of products sold.</p> <p>Collective marketing, distribution etc offers reduced costs.</p> <p>Co-operatives are sometimes offered exemption from restrictive trade practises.</p> <p>Price of goods / services can be controlled.</p> <p>Members have control over their products and plan use of infrastructure.</p> <p>Regimented structure focuses business strategy and encourages performance management.</p> <p>Co-operative ownership encourages customer loyalty.</p>	<p>Often used for local government outsourcing.</p>
Access to support services		<p>Mainstream professional support services unlikely to be familiar with structure.</p>

Fact Sheet 4

Industrial and Provident Society for the Benefit of the Community

What is an Industrial and Provident Society for the Benefit of the Community?

Two forms of Industrial and Provident Society (I&PS) exist, a bona-fide co-operative and a society for the benefit of the community. This section deals with the latter, referred to here as an I&P Community Benefit Society.

An I&P Community Benefit Society is a democratic not-for-profit organisation similar to an I&PS Co-operative but with the primary objective being to serve the interests of the broader community, not just its membership. Instead of a Memorandum and Articles of Association, as required by Company Law, I&P Societies are governed by their 'Rules'.

An Industrial and Provident Society is a corporate body registered under the Industrial and Provident Societies Acts 1965-1978. To be registered as an I&PS an organisation should carry out "an industry, business or trade, whether retail or wholesale". For an I&P Community Benefit Society less specific objectives are required than in an I&PS Co-operative.

Registration as an I&P Community Benefit Society requires the enterprise to persuade the FSA that there are 'special reasons' why it should be registered as an IP&S rather than as a company. In the absence of any statutory definition of 'special reasons' the FSA has discretion on this. It notes however that *'a company should be "special" in that there is some concrete advantage or benefit to be gained which would be lost or unobtainable as a company'*⁷.

Co-operatives^{UK} consider that the legal framework regulating I&P Societies is generally more sympathetic to social benefit and co-operative organisations in that the administrative and statutory requirements are more lenient. They also note that the I&PS Act places greater trust in directors acting "in good faith" and is less complex and punitive than Companies Act legislation.

Basic Principles of an I&P Community Benefit Society

The FSA requires that an I&P Community Benefit Society satisfy the following conditions⁸:

- *Conduct of Business*: It is run primarily for the benefit of people who are not members of the society and should be in the interests of the community at large.
- *Interest on Share and Loan Capital*. It will usually issue more than nominal share capital (e.g. £1 share per member). Where members make loans to the society interest paid must only be that necessary to obtain sufficient capital to undertake activities.

⁷ Financial Services Agency. 2002. Information on the Registration of Benefit of the Community Societies Under the Industrial and Provident Societies Act 1965.

⁸ Taken from Financial Services Agency. 2002. Information on the Registration of Benefit of the Community Societies Under the Industrial and Provident Societies Act 1965.

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- *Profits and Assets*: Rules must not allow profits to be distributed to members. Profits must be used to further the objects of the society and be ploughed back into the business.
- *Dissolution*: Rules must not allow assets to be distributed to members or used for private gain on its dissolution.
- It must have at least three members, unless it consists of two registered societies.
- The FSA generally does not grant I&PS status to organisations which seek to have different classes of members, each with different rights.

Legal and Financial Issues

- Unlike limited companies, there is no 'I&PS limited by guarantee'. It is possible however to stipulate that one share will be issued to each member at a nominal value which will realise no dividends or interests. This is how I&P Community Benefit Societies are structured.
- Co-operatives^{UK} consider that the model is well suited to community businesses, permitting members of the community to invest in the enterprise without distorting its democratic control and with at least a reasonable expectation that they will be able to withdraw their investment if required.
- An I&PS issues shares. Shares with an I&PS are however different from those in normal companies.
 - I&PS shares are redeemable, subject to the rules of the Society.
 - I&PS shares are usually issued at a fixed value. As a result shares are worth the same amount they were purchased for when they are redeemed, there is no capital growth.
- Return on capital raised through loans or shares must be limited to the rate necessary to raise and retain sufficient money to fund the enterprise's activities.
- Debentures are often issued as a method of raising capital. A debenture is a type of bond entitling the owner to periodic capital and interest, that has no assets pledged as security. Debenture holders are therefore considered as unsecured creditors
- An I&P Society is subject to corporation tax.
- Under I&PS legislation if a Society is wound up while solvent, its residual assets can be redistributed to members for personal profit. This act, which could be considered to be contrary to International Co-operative Principles, raises the possibility that members may seek to wind up a Society to realise the value of its assets. As such an I&P Society must clearly decide whether this is an acceptable event, and if not, decide how to structure itself to deny members the possibility of doing so.

- Legislation restricts individual shareholdings to a maximum of £20,000 per member.
- Voting rights are not attached to shareholding. Instead voting is performed on a one-member one-vote basis.
- Registration as an I&PS is cheaper, easier and faster if done through a sponsoring body using model rules.
- The strict control of I&P Societies by the FSA includes their ability to refuse any changes to the Rules that they consider are in breach of the spirit of the Society. Whilst this can be considered to reduce the independence and decision making autonomy of the Society, it does offer an 'independent' monitor who will help safeguard the Society's objectives and mission.
- If its objectives or activities are charitable, as defined by the Charity Commission, an I&PS may receive 'exempt charity' status from the Inland Revenue and receive the tax benefits of charitable status. It may not however register separately with the Charity Commission and therefore will not receive a charity registration number. This can deter some donors from contributing to an I&PS although it does not prevent an organisation receiving charitable funding.

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Summary: Industrial and Provident Society for the Benefit of the Community

	Strengths	Weaknesses
Cost and Ease of Establishment	<p>Medium/high cost of formation. £240.</p> <p>Takes longer time to set up than Companies: 1-2 weeks minimum.</p> <p>Requires minimum of 3 members.</p>	<p>Easiest and cheapest registration requires sponsor (e.g. ICOM.)</p>
Administrative Costs and Requirements	<p>Registration Costs⁹:</p> <ul style="list-style-type: none"> ● £100 using model rules and no changes. ● £120 using model rules and 1-6 changes. ● £350 using model rules and 7-10 changes. ● £950 using model rules and 11+ changes or freely drafted rules. <p>Annual Fee: (based on size of assets)</p> <ul style="list-style-type: none"> ● £0-50K: £60 ● £50-100K: £100 ● £100-250K: £150 ● £250K-£1m: £200 ● £1m+: £370 	<p>Annual return must be submitted to the FSA.</p> <p>FSA must be informed of any change of address, name or rules.</p> <p>Membership records have to be maintained.</p>
Constitutional Limitation	<p>The 'rules' of an I&PS are usually straightforward and easy for members to understand.</p> <p>Difficulty in changing rules and requirement of FSA approval helps safeguard objects and assets from being 'hi-jacked' by members for personal benefit.</p>	<p>Changing rules requires approval of FSA and can be time consuming.</p>
Regulatory Environment	<p>Regulations do not change frequently and are relatively simple.</p>	<p>Regulations are somewhat old but were designed with the needs of social enterprises in mind</p>
Investment and Financial Implications.	<p>Qualification loans from members.</p> <p>Dividends paid on loans.</p> <p>Charitable / grant funding possible</p>	<p>Capital can only be raised through share issues to members.</p> <p>Speculative capital investment is not an option.</p>
Tax, NI and Pensions	<p>If mutual tax status granted, dividends are paid before tax.</p> <p>Tax benefits if charitable status granted.</p>	<p>Full tax, NI contributions and corporate rates apply unless charitable status obtained.</p> <p>No charitable number available which deters some donors and support.</p>
Governance / Management	<p>Community / member ownership and control.</p>	<p>Community / member ownership and control.</p>
Change and Sustainability	<p>Society continues if members die or leave.</p>	<p>Changes to rules are hard to achieve and slow.</p>

⁹ Indicative figures as of September 2002

	Strengths	Weaknesses
Implications for Business Strategy	<p>Price of goods / services can be controlled.</p> <p>Regimented structure focuses business strategy and encourages performance management.</p> <p>Co-operative ownership encourages customer loyalty.</p> <p>Good for charitable trading firms because less restrictive.</p>	<p>Not recommended for capital intensive projects.</p> <p>Often used for local government outsourcing.</p>
Access to support services		<p>Mainstream professional support services unlikely to be familiar with structure.</p>

Fact Sheet 5

What is a Co-operative?

What is a Co-operative?

The term co-operative is widely misunderstood in the UK and particularly within the social enterprise sector. Co-operatives are 'for-profit' organisations that seek to benefit members through market based trading activities. Mutual self-help organisations that do not engage in 'business' should not be regarded as co-operatives, but voluntary organisations.

Co-operatives do not exist as distinct entities clearly defined in English Law. Instead co-operatives are understood to mean organisations which are governed by the co-operative principles as prescribed by the International Co-operative Association (ICA).

The primary objective of a co-operative is to benefit its members, through access to goods and services provided by the co-operative. The benefit members receive is in proportion to their level or participation in the co-operative, in contrast to most investor-led businesses (where the business exists primarily to increase the value of shareholdings for investors). It is the democratic and equitable nature of benefits from co-operative organisations that differentiates them from other business forms.

Co-operative principles may be applied in a wide variety of circumstances, wherever a group of people (or organisations) have a common need and that group seeks to meet this need collectively and on a democratic and equitable basis.

Co-operatives can be formed using different legal forms including I&PS and company structures. The legal form therefore does not define an organisation as a co-operative.

Similarly, it can be argued that strict adherence to co-operative principles does not, in itself, define an organisation as a co-operative. As Plunkett Patron Edgar Parnell notes: *'Many people involved in co-operatives find it just as difficult to define a 'co-operative' without referring to 'co-operative principles.'* This obsession with principles has brought an unnecessary complexity to the understanding of the co-operative form of business, and has diverted attention from the essential simplicity of the concept of co-operation. This fact alone has probably been one of the greatest barriers to the expansion of co-operative forms of enterprise in recent times.'

Parnell further states that co-operatives are best identified by their purpose and objectives rather than by their legal form. *'The most significant feature of a co-operative is that it exists to serve the needs of the members who ultimately own and control it. These owners may be individuals or other corporate bodies. Their reasons for becoming members are normally based upon their wish to receive services or 'benefits' from it. Membership of a co-operative should not be regarded as a means of getting the maximum return on whatever investment one may have made in a co-operative. In simple terms this means that the prime task of a co-operative is providing benefits to its members in their capacity as users of its services.'*

Co-operative Principles

1. Membership is voluntary.
2. The co-operative's board is elected on a one-person one-vote basis. In co-operatives composed of members other than individuals (for example secondary service co-operatives comprised of individual businesses) the election of the administration should be democratic.
3. The interest paid on shares and investments in the co-operative should be limited.
4. Surplus distribution should be done in a manner that avoids being at the expense of another member.
5. Members, officers and the general public should be educated about the principles and techniques of co-operation.
6. Co-operatives should co-operate with other co-operatives.

Key Features of Co-operatives

- Co-operatives exist for the benefit of their participating members, not investors.
- The profits of a co-operative belong to its members. They can be used solely for benefit of members or for the benefit of the wider community.
- Because surplus profits of a co-operative can be distributed to members, co-operatives are regarded as being closer to the private sector than voluntary organisations. They are therefore more readily able to raise finance through traditional commercial sources. As a result they are often less likely to be able to gain access to grants or charitable donations.
- Benefit to members is primarily through access to goods and services provided by the co-operative, not through capital growth of their investment in the co-operative.
- Co-operatives are democratic organisations. Money invested in a co-operative does not automatically secure the ability to control the co-operative.

Two Key Issues in Co-operative Enterprise Models

Mutuality

Mutuality refers to the congruence of group(s) of participants with the co-operative and its membership. Being "mutual" means that participants and members are one and the same and that the co-operatives income is derived from the activities of its members. A housing co-operative, where the members and participants of the co-operative are the same would be considered "mutual", but a co-operative shop which derives part of its income from non-members (i.e. passing trade) would not be considered as "mutual."

Mutuality offers co-operatives important tax benefits. Mutuality does however have certain disadvantages, for example in prohibiting business being conducted with non-members alternative revenue may be denied.

Common Ownership

The term common ownership refers to the prohibition of the distribution of the proceeds of the sale of assets of a co-operative on its dissolution. Co-operatives may or may not be common-ownership organisations.

Fact Sheet 6

Charitable Status¹⁰

What is Charitable Status?

Charitable status does not represent a distinct legal organisational structure. Instead charitable status is conferred to organisations “on top of” their legal structure, providing them with specific advantages but also additional responsibilities and restrictions. Charities can exist as associations, trusts, companies limited by guarantee and I&PS Societies for the Benefit of the Community. However other forms of company and I&PS cannot attain charitable status. In a charitable company the board members are the trustees of the charity.

All monies, property and assets of the charity are held in trust, that trust being between founders/donors (who gave the money), the governing body (who administer the organisation) and the beneficiaries. All members of a charity’s governing body are therefore charity trustees, whether or not the charity is structured as a Trust.

Which Organisations Qualify for Charitable Status?

Organisations can apply to the Charity Commission to claim charitable status.

All decisions on what is charitable in law are based on the preamble to the Charity Uses Act 1601, which defined charitable purposes as:

‘The relief of aged, impotent and poor people; the maintenance of sick and maimed soldiers and mariners; schools of learning, free schools and scholars of universities; the repair of bridges, ports, havens, causeways, churches, sea banks, and highways; the education and preferment of orphans; the relief, stock or maintenance of houses of correction; the marriages of poor maids; the supportation, aid and help of young tradesmen, handicraftsman and persons decayed; the relief or redemption of prisoners and captives; and the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers, and other taxes’.

This is still the only statutory definition of charity. It is therefore the starting point for arguments about whether or not an organisation is charitable in law. There is an assumption that ‘charitable’ and ‘socially responsible’ are broadly interchangeable terms. However this is not the case, many activities that the general public would regard as ‘socially responsible’ are not ‘charitable’.

In 1891, Lord MacNaughton offered a classification of charitable objects which remains the basis of judgement on charities today.

- The relief of poverty
- The advancement of education
- The advancement of religion
- Purposes beneficial to the community.

¹⁰ This sheet is informed by the NCVO publication “An introduction to the legal implications of trading.”

Although this final category ‘purposes beneficial to the community’ may sound all embracing it is not as wide ranging as it sounds. To qualify under this heading an organisation must prove, by analogy if necessary, that the activities are included within the 1601 statute.

The Charities Commission has recently accepted the relief of unemployment and urban and rural regeneration as charitable endeavours. Social enterprises that have these as their primary objectives may therefore be able to qualify for charitable status.

Sometimes charitable status can be granted to organisations without having to have formal approval by the Charity Commission if they are:

- **Exempt Charities.** There is a long list of these, including universities and many national museums and galleries. In addition a registered society under the Industrial and Provident Societies Acts is also exempt. Therefore a Society for the Benefit of the Community with charitable status does not to register with the Charity Commission at all, although the group still needs Inland Revenue approval. All exempt Charities will not receive a charity number but the organisation does have all the privileges and duties of a charity.
- **Excepted Charities.** This includes those charities with a total annual income of less than £1,000, or registered places of worship.

Legal Form and Charitable Status

Charitable status can be afforded to any legal form as long as its aims are deemed to be within the criteria specified by the Charities Commission. It is important to note however that there are constraints in charities governance structures. There are problems for example for with any employee of a charity being trustees as a trustee is not supposed to benefit from a position of trust. Therefore worker co-operatives cannot be charities under any legal form (CLG or partnership for example). In addition charitable organisations cannot, in general, include employees or beneficiary representation on its governing body as a stakeholder group.

Restrictions on Charities

Duties of Trustees

Management committee members of charities have duties and liabilities as charity trustees over and above those they might have as, for example, company directors. For example, the use of a charity’s property outside its objects and powers would be a breach of trust and the trustees may be held personally liable to reimburse the charity. There is a high degree of responsibility involved

Payments to Trustees

A trustee is not supposed to gain from a position of trust. There must be no payments to trustees, other than reasonable expenses or for the payment of normal professional fees. Therefore, except in exceptional circumstances, no employee of a charity can serve on its governing body. This can also create problems for self help groups because trustees are not supposed to be beneficiaries.

Political Activities

Activity supporting a political party is not allowed, but political activity may be undertaken as long as it is ‘based on a well-founded and reasoned case and is expressed in a reasonable way’. However, there are limits on campaigning and any campaigns must be within the charity’s objects.

Section 7

Organisational Structures for Rural Social Enterprises

Property

There are restrictions on selling, leasing and mortgaging of property and of investments by charities. Generally charities are meant to secure the best return on their assets for the benefit of their beneficiaries. This has unintended consequences, for example it can be difficult for a charity to make ethical investments.

Changes to Objects

It is difficult to change the objects of a charity. Firstly, there must be an explicit power to do so in its rules and secondly any change must be approved by the Charity Commission or the Registry of Friendly Societies, as appropriate. The Charity Commission in particular is reluctant to change objects without good reason.

Charitable Organisations and Trading Activities

There is no absolute prohibition on charities being able to trade. Charities that wish to trade should however consider both the Charity Law and Tax Law restrictions that may apply to them. The Inland Revenue defines trading as “*the sale of goods or services to customers as part of a commercial enterprise.*”

Charities can trade as long as doing so is a direct means of achieving its primary objective. This is known as **primary purpose trading**. For example a charity may trade by charging fees for educational services it provides. Many British public schools are registered as charities in this way.

Charities can also trade if the process of trading benefits the charities target beneficiaries. This is known as **beneficiary trading**. For example, a charity established to provide work experience and training for disadvantaged employees may trade its products to sustain itself. Such an organisation can employ non-beneficiary staff, but they should be a minority.

Other trading activities which are not related to the charities primary purpose may be allowed, depending on their relationship with the charities primary purpose. This form of trading is known as **ancillary trading**. For example a school may sell materials or books to pupils.

Occasional trading may also be permitted to enable charities to raise funds from small-scale events like car boot sales. This is only permitted if the profits are used for charitable purposes and the revenue generated from such activities is below £5,000 or £50,000 when that does not represent more than 25% of the charities annual turnover.

Establishing a Trading Subsidiary for a Charity

If trading activities are not directly undertaken to fulfil the charities primary objective, then charities can establish a separate trading arm which can covenant surpluses to the charity in a tax efficient manner using the *Gift Aid* scheme. This allows the trading subsidiary to receive tax relief on funds donate to the charity. The constitution (Memorandum and Articles of Association for a CLG or Rules for an IPS) should first be checked to ascertain if the charity has the authority to support the formation of a trading company.

Charity financial support to establish a trading arm can be through loans, equity investment, donations or guarantees. Careful consideration should be paid to the legal and tax implications of the vehicle chosen to finance the trading subsidiary. Key issues to consider when assessing whether or not to establish a trading subsidiary include:

- Subsidiaries are expected to be self-financing after 5 years.
- Risks involved to the charity's assets and associated restrictions when using charity funds to finance a start-up.

The establishment of a trading subsidiary raises a further dilemma for the charity and its trading arm. Charities must balance the benefits of receiving surplus profits from the trading arm with the need for the trading arm to retain profits to be able to finance its own organic growth. By being able to retain surpluses for such use the trading arm will incur taxation.

Governance and Control of Trading Subsidiaries

If a separate trading company is required then attention must be given to ensure that its assets are "locked in" and that the subsidiary cannot be "spun-off" to provide benefits to individual members. This can be achieved by issuing golden shares that are held by a third party, which empowers them to veto changes in the constitution of the company.

Advantages and Disadvantages of Charitable Status

Advantages	Disadvantages
Can lend an organisation "legitimacy" and the impression of accountability.	Takes time to be processed and granted by the Charity Commissioners.
Is a prerequisite for some donors and funding bodies to offer support and charitable status will often help in raising funds	Restricts permissible trading activities (and other activities such as political activities)
Removes the company tax burden on the organisation.	Restrictions may force Social Enterprises to form complex corporate structures to enable trading activities to be undertaken by an arms-length subsidiary.
Reduces costs: Charities receive a mandatory 80% relief of rates on their premises. Local authorities have discretion to relieve a further 20% of rates.	Charitable status means that the board of directors or trustees can't be paid therefore limiting the number of skilled professional input available.
Charities can also benefit from other relief and exemptions such as: tax relief (exemption from corporation tax), certain VAT relief, and exemption from stamp duty on conveyancing	
Donors can receive tax relief on donations	