

A BRIEF GUIDE TO Legal Structures



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Introduction

This guide will help you to select the most suitable legal structure for your community business. Before trading, a community group should investigate the function of possible legal structures that match what they are trying to achieve and the governing documents that support that structure. The governing documents are known as the Rules, or Articles of Association, and add the clarity and understanding about the establishment and running of the enterprise.

The five main choices usually available to a community-owned social business across all nations of the UK are:

- 1. Community Benefit Society**
- 2. Co-operative Society**
- 3. Community Interest Company**
– usually with a large membership
- 4. Company Limited by Guarantee**
- 5. Charitable Incorporated Organisation**

Plunkett can also offer funded support from a specialist adviser to help you identify which legal structure might be the most appropriate for your business.

To find out more about this support visit www.plunkett.co.uk, or contact us at or call **01993 630022**.

Starting out

When creating a community business, a committee of at least three founder members is required to take on the responsibility of managing and leading the intended enterprise.

The committee is effectively the management committee of an unincorporated organisation. The committee should represent the interests and concerns of the wider community when assessing the viability of a community business and exploring possible options for how it would be set up and managed. The committee of founder members has the responsibility of setting out its aims and objectives from the outset, as well as allocating roles and responsibilities in order to have a clear purpose and achievable, measurable, scheduled objectives.

At this early stage, some groups choose to form an unincorporated association, which is an agreement between a group of people who have formed a committee to establish an enterprise, rather than to trade and make a profit. An unincorporated association cannot be registered as a legal entity and does not cost anything to establish; importantly, it does not offer limited liability so individual members are personally responsible for any debts and contractual obligations.

It is therefore important to choose the right time to adopt a legal structure, also known as incorporation, and to benefit from limited liability. This may be when the project has the support and participation of the community, a feasibility study has been completed and it is likely that the enterprise will be established. In order to protect individuals from personal liability, it is advisable to incorporate before trading, employing staff, managing volunteers and entering into contracts and financial arrangements. The management committee must, therefore, consider a legal structure to ensure they are compliant with legal necessities such as tax, insurance, trading standards and employment rights.

The benefits of incorporation are:

- The community business becomes a legal entity in its own right, transferring liability from the individual to the organisation
- Liability is limited to the amount of paid share capital or guarantee
- Members are part of a corporate body that can own property, employ staff and enter into contracts
- The business can borrow money and receive grants if eligible
- There is reduced personal risk, which is equally distributed amongst members.

Plunkett UK recommends that a community business should adopt a legal structure which enables genuine community ownership, with equal democratic control, and this also forms the criteria of our eligibility criteria when delivering support.

We would expect this to include:

- Open and voluntary membership
- One member, one vote
- The interests of the business to be linked into community control, disallowing any one member from having greater control than others
- No profit distribution to members based on investment other than a payment of interest at the discretion of the management committee.

Alongside incorporation sits the governing document, which is a written statement that sets out the purpose of the organisation, its structure and a description of how the organisation will operate. It should include the aims of the organisation, who the members are and how they make decisions, what happens to operating surpluses, and what happens to the assets if the organisation is sold or broken up. This document is referred to as the Rules or Articles of Association.

Choice of legal structures

1. Community Benefit Society (CBS)

A Community Benefit Society (CBS) is an organisation conducting an industry, business or trade for the benefit of the community. It is a corporate body registered under the Cooperative and Community Benefit Societies Act 2014 and authorised by the FCA. It is registered as a Limited Company and although it will appear on the register at Companies House, the FCA manages annual returns and accounts. The primary purpose for a CBS is to help more people take control over their economic lives, by owning and controlling the businesses in which they work or operate. Being similar in nature, the rules of both a CBS and a Co-operative Society are usually written to operate according to the seven core principles and values which were adopted by the International Co-operative Alliance in 1995.

- Voluntary and open membership
- Democratic member control
- Economic participation of members
- Autonomy and independence
- Education and training
- Working with other co-operatives
- Concern for the community

A community benefit society provides services for the wider community as well as its members, and pre-tax trading profit can be reinvested in the enterprise, used to pay interest to shareholders, redeem withdrawable community shares or distributed for social or charitable purposes in accordance with the rules. It is a democratic structure that encourages a large membership and empowers communities by giving members a direct say in the management of the enterprise through the elected committee. Membership of a CBS is established by the purchase of at least one share and the price of a single share is decided at registration of the enterprise. An important feature is that there is one vote for each member, irrespective of how much is invested in the enterprise.

The benefits of a large membership base include:

- Having a large number of people who have a financial interest in the enterprise and because of this are more likely to support it
- A greater number of people who attend AGMs and committee meetings and positively contribute to the overall direction of the business
- A more accessible pool of people to draw on when elections for committee members are requested, or when more volunteers are needed.



Key features of a CBS

- Benefits wider community as well as members
- Elected committee manage the enterprise on behalf of members
- One member, one vote
- Member liability limited to share value which cannot increase
- Statutory asset lock using Plunkett UK's Model Rules
- Shares can be withdrawable at the discretion of management committee
- Can pay interest to shareholders at a rate to retain sufficient capital
- FCA approved and registered with Companies House
- Annual return AR30 to be submitted to FCA
- Is not regulated by Company Law but should always act in accordance with the law
- Trade profits can be reinvested or distributed for social or charitable purposes
- Depending on the type of enterprise, can qualify for tax relief on investment

An active and engaged membership is to be encouraged and is likely to be the key to the success of the enterprise. Members will become your management committee, your customers, your volunteers, your staff and your advocates.

A CBS can be a vehicle for raising investment finance in the community by offering community shares which can be withdrawable; that is shares that can be sold back to the enterprise, and offer interest at a rate to retain enough capital to run the business. Community shares are exempt from the prospectus regulations appropriate to UK Company Law which makes it easier for societies to raise finance from their members without incurring expensive legal fees.

For some models of community enterprise, community shares can be eligible for personal Seed Enterprise Investment and/or Enterprise Investment Scheme income or capital gains tax reliefs with or without advance assurance from HMRC on qualifying trading activities. [Tax relief for investors using venture capital schemes – GOV.UK \(www.gov.uk\)](https://www.gov.uk/guidance/tax-relief-for-investors-using-venture-capital-schemes).

From March 2018 HMRC introduced an additional risk-to-capital condition in an effort to stop capital preservation schemes. HMRC will apply a principles-based test to ensure that the capital raised is genuinely being put at risk within the enterprise and not being preserved, for instance through the acquisition of property.

It is advisable to seek further advice from Plunkett UK if you are planning to offer withdrawable share capital and for further information on tax relief. The statutory maximum investment in a CBS is £100,000 for an individual, or in the case of an investment by other societies, the amount is unlimited. Having said that, we recommend that societies limit the amount of share capital that an individual can hold if they believe it to be in the best interest of the society to do so and to protect the stability of the enterprise.

The rules of a CBS make it clear that the enterprise will not directly benefit individual members and is acceptable for most types of grant funding.

Another important feature of a CBS is a statutory asset lock. This is written into the rules and is designed to prevent an enterprise from distributing assets amongst members on solvent dissolution over the value of their share. Instead surplus assets can be transferred to another organisation that supports the objects of the society.

Some Community Benefit Society businesses may be concerned with managing community facilities and assets, rather than owning them, and delivering services, rather than trading goods for fundraising. If these are for Primary Purpose Charitable trading, then it may qualify for Exempt Charitable status with HMRC for tax purposes. Examples may include educational, health and social care, environmental, arts and social inclusion facilities or services.



Charitable Community Benefit Society (CCBS)

A Charitable Community Benefit Society (CCBS) must have exclusively charitable objects that are for the public benefit and would have to be registered by the FCA and HMRC as an exempt charity for tax purposes in England and Wales.

Exempt charities (CC23) – GOV.UK (www.gov.uk)

In Scotland, there is no 'exempt charity' status and to become a Charitable Community Benefit Society it must also apply to the Scottish Charity Regulator to be a registered charity. To obtain tax benefits the organisation will also need to apply to HMRC. The same is true in Northern Ireland, where charitable community benefit societies must become registered charities with the Charity Commission for Northern Ireland, and apply separately to HMRC for tax benefits.

An advantage for a charitable CBS is that it can offer a limited return on community shares as a means of raising working capital and engaging with the wider community. If secondary fundraising trading activities are not covered by a Primary Purpose Charitable trading tax exemption, a charity may want to consider conducting these activities through a subsidiary trading company and transferring some or all of the profits of that company back to the charity as a donation.

Plunkett UK can help you to register your community business as a Community Benefit Society with Model Rules pre-approved by the FCA.

To find out more about this support contact us on www.plunkett.co.uk, or **01993 630022**.

2. Co-operative Society

Like the CBS, a Co-operative Society is a corporate body registered under the Co-operative and Community Benefit Societies Act 2014 and regulated by the FCA.

A co-operative Society is a business that is owned and controlled by its members and exists primarily to benefit its members.

All members have an equal say in how the business is run and how to distribute profits, whether amongst themselves in the form of a dividend, to reinvest in the business or used to support community groups. It can raise money through community investment and may qualify for some grant funding if a statutory asset lock is in place.

Key features of a CBS

- Exists primarily to benefit members
- Elected committee manage the enterprise on behalf of members
- One member, one vote
- Member liability limited to share value which cannot increase
- Choice of limited or Statutory asset lock (may affect grant funding)
- Shares can be withdrawable at the discretion of management committee
- Can pay dividends to members from trading profit
- Annual return AR30 to be submitted to FCA
- Is not regulated by Company Law but should always act in accordance with the law
- Depending on the enterprise, can qualify for tax relief on investment

Find out more about becoming a co-operative society by visiting the Co-operatives UK website:

www.uk.coop



3. Company Limited by Guarantee (CLG)

A CLG is a limited company governed by its

Articles of Association, which can be written to benefit the community. This can be by trading to make a profit and investing the surpluses back into the business or to make charitable donations. Under Company Law, the articles have to be written by a qualified person. It is most commonly used when a group do not need share capital, it is quick and easy to set up and, if required, can be converted to a society at a later date.

A CLG is regulated by Companies House and subject to company law and is widely recognised and understood by banks, public bodies and other businesses. In a CLG there is no share capital and no shareholders. Instead, the members benefit from limited liability and give a nominal guarantee to cover the company's liability in the event of winding up. Depending on the articles, a CLG may qualify for grant funding and can take out loans, but it cannot issue shares as a way of raising finance or offer interest or dividends.

Key features of a Company Limited by Guarantee

- Managed by Directors
- Dependent on its articles to establish governance and ensure community benefit
- Members liability limited to amount unpaid by guarantee
- Cannot pay interest or dividends to members
- Cannot raise investment shares from community
- Quick and easy to establish, although a lawyer may be needed for the Articles
- Regulated by Company Law



4. Community Interest Company with a large membership

Community Interest Companies are trading enterprises set up to benefit the community.

A CIC is a limited company formed under the Companies Act 2006 and is subject to company law. It can be limited by guarantee or by shares, and those shares can be transferable and redeemable. This means that the owner of shares in a CIC has to either find a buyer for the shares if transferable or may be able to sell the shares back to the company if redeemable at the Company's option. This is a regulated activity under company law and is likely to incur the costs of an FCA approved person to manage this activity.

A large membership CIC ensures that control is given to members and the governing document is the Articles. A large membership is more likely to qualify for grant funding. When setting up a CIC, a community group must supply the CIC Regulator with a community interest statement to show the purposes of the company, the range of activities which it will undertake in order to promote the purpose, and the sections of the community which the CIC is intending to benefit. The Office of the Regulator of Community Interest Companies decides whether an organisation is eligible to become, or continue to be, a community interest company (CIC). It is responsible for investigating complaints – taking action if necessary – and it provides guidance and assistance to help people set up CICs.

A CIC must file an annual Community Interest Report alongside its accounts with Companies House, and copied to the CIC Regulator to show what the CIC has done to benefit the community during the year. It must also provide supporting information on directors' remuneration, dividends declared, and interest paid on any capped loans.

CICs limited by shares are subject to a dividend cap which allows a CIC to distribute up to 35% of profits to shareholders with 65% being reinvested in the business or the community. Directors can be paid within the distribution cap and the amount has to be agreed at a resolution of the members. The Regulator, in consultation with the Secretary of State, has the ability to change the terms of the dividend cap from time to time. A CIC has the ability to carry forward unused dividend capacity but cannot exceed 35%.

An essential feature of all CICs is the statutory asset lock, which is designed to make sure that the assets of the CIC are used exclusively for the benefit of the community. Any assets and profits reinvested in the business must be retained within the CIC and used solely for community benefit. The only bodies to which assets are allowed to be transferred are other asset-locked bodies.

CIC's are quick and easy to establish through: *Community interest companies: forms and step-by-step guides – GOV.UK (www.gov.uk)* but we would recommend all groups seek advice before deciding on which might be the most appropriate legal structure to meet their organisation's aims and objectives.

Key features of a Community Interest Company

- Small and large membership CIC available – large more suited to community controlled enterprise
- Redeemable and transferrable shares subject to Company Law
- Limited liability to the value of a share or guarantee
- Regulated by Company Law
- Statutory asset lock
- Can pay interest to shareholders

5. Charitable Incorporated Organisation (CIO/SCIO)

A community business that is not principally established to generate profits may be able to conduct Primary Purpose Charitable trading through a CIO legal structure. There are two types, an Association model suitable for community businesses with a wider membership, and a Foundation model which limits membership to Trustees only.

An Association Model CIO allows a registered charity to trade, is registered by the Charity Commission in England and Wales and is subject to charity Law.

Charitable incorporated organisations (PG14a) – GOV.UK (www.gov.uk)

In Scotland an SCIO is administered and regulated by a single body, the Office of the Scottish Charity Regulator ('OSCR'). Charitable companies, which are also incorporated, report both to OSCR and to the Registrar of Companies ('Companies House').
OSCR – Becoming a SCIO

It is not possible to set up a CIO in Northern Ireland at present as that section of the Charities Act (Northern Ireland) 2008 is not yet in force. *Charity registration: FAQs – The Charity Commission for Northern Ireland (charitycommissionni.org.uk)*

Trustees will benefit from Limited Liability. A CIO cannot raise share capital from the community. In order for a charity to register as a CIO, the objects must be exclusively charitable and meet the public benefit test. Although a community-owned enterprise may appear to have charitable objects, HMRC view that selling goods and services to customers to make a profit is non-charitable for tax purposes. A charity that wishes to trade for a profit, even if that means trading for the benefit of the community, must have a separate trading arm for the trading element of their work.

If trading activities are not covered by a tax exemption, a charity may want to consider conducting these activities through a subsidiary trading company and transferring some or all of the profits of that company back to the charity as a donation.



Frequently asked questions

What is the difference between a community benefit society and a co-operative?

A co-operative society is run for the mutual benefit of its members while a community benefit society provides services for the wider community as well as its members.

What does it cost to register a legal structure and how long does it take?

This varies depending on the organisation you are working with, and what the package of support includes. It can be very inexpensive and quick to purchase an 'off the peg' company such as a CIC or Company Limited by Guarantee although the cost of writing the articles for a CLG will increase costs significantly as will the costs of writing share offer documents and dealing with redeemable and transferable shares in a CIC. Plunkett UK has developed a set of Model Rules (template

governing document) for a Community Benefit Society which has been approved by the Financial Conduct Authority (FCA). By using these rules, a community enterprise can be assured of a tried and tested model and benefit from a reduced registration fee when registering the rules with the FCA.

Plunkett UK can register your legal structure as a Community Benefit Society for a cost of £310 for Community Business Members. The fee is increased if changes to the rules are required. This fee includes support from a member of the Plunkett team to ensure that it is the right structure for your enterprise, ongoing support once registration has taken place and all administrative costs to set up. It also includes liaison with the FCA during the registration process. Following registration, we can support you when preparing share offer documents and suggest that you contact us if and when you are considering this to see what support is available.



Can a CBS be used for more than one trading enterprise?

In theory, a CBS can cover multiple projects within the same purpose providing the purpose is broad enough and the members would have to decide by a vote whether they wanted that to happen. However, there are issues if societies try to compartmentalise projects into different shares, because in practice the risk isn't compartmentalised. If one project failed the liability wouldn't be confined to only those shareholders who subscribed capital for the purposes of that project.

Is a CBS protected under the Financial Services Compensation Scheme (FSCS)?

CBSs are protected in the same way that companies are. The 'small company' definition in the Companies Act 2006 is applied to a CBS as it is classed as a company for the purpose of FSCS.

What is a Community Interest Company with a small membership?

A CIC with a small membership is where all members are directors. There is no upper limit to the membership as long as all the members are also registered directors of the CIC. This would be impractical if encouraging a large membership.

How does a trading arm of a charity work?

If trading activities are not covered by a tax exemption, a charity may want to consider conducting these activities through a subsidiary trading company and transferring some or all of the profits of that company back to the charity as a donation.

Does all of this apply across all UK nations?

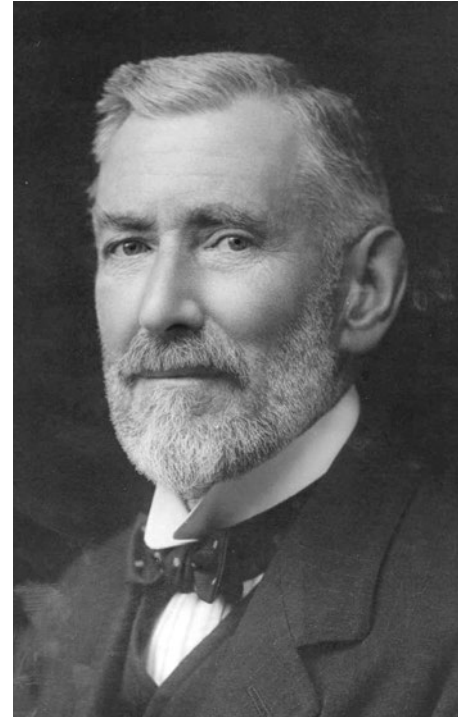
In principle, yes, however there are some differences. In Scotland, charities are registered and regulated by OSCR, rather than the Charities Commission and there may be circumstances when a group may want to discuss with OSCR whether or not they meet the conditions for charitable status. This is more likely to apply to particularly remote groups. If awarded, a group may still need a trading arm if trading is the primary purpose.

- Further support in Scotland can be found through Development Trust Association Scotland (DTAS) www.dtascot.org.uk
- Legislation is different in Northern Ireland and further information can be found from Charity Commission for Northern Ireland www.charitycommissionni.org.uk or Co-operative Alternatives www.coopalternatives.coop
- The tax, legal system and regulatory bodies in Wales are the same as in England. The Charity Commission Office in Newport operates bilingually in Welsh and English. Further advice and support in Wales can be found at Cwmpas cwmpas.coop and Development Trust Association Wales dtawales.org.uk.

About Plunkett

Plunkett UK is a national charity which supports people in rural areas to set up and run a wide range of businesses in community ownership. We do this to achieve our UK-wide vision for resilient, thriving and inclusive rural communities. Community-owned businesses are owned and controlled by community members who have an equal and democratic say in how the business is run.

Plunkett has promoted the community ownership model for over 100 years because of its track record for delivering better businesses for people, communities, the economy, and the environment. Today, we represent 800 trading community-owned businesses and a further 500 in the process of setting up. Plunkett raises awareness of the community business model, provides practical community business support, and represents our members through networking, research and advocating with government, think tanks and funders.



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