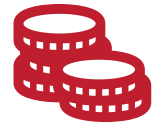


Selecting The Right Legal Structure For A Social Enterprise

The intention of this factsheet is to provide general information, which can then be followed up with more in depth discussion to develop specific individual business requirements.

It is very important to ensure that you select the right legal structure for your business. The type of legal structure adopted by a social enterprise is dependent on profit distribution, control of the enterprise and asset ownership. If you have further queries, please seek legal advice as SEE Ahead are not Lawyers.

▶ How will the Profit be distributed?



To assist with identifying the most appropriate legal structure, one of the key areas to determine is profit distribution.

Your answers to the following questions will guide you to specific structures:

- Will profit be distributed between an entrepreneur and shareholders?
- Will profit be retained by the enterprise to sustain its development and further its aims?
- Will profit be distributed amongst any members?
- Will profit be distributed for the benefit of community organisations and other social enterprises?

▶ Who will Control the Enterprise?

To assist with identifying the most appropriate legal structure, one of the key areas to determine is control of the enterprise. For a social enterprise it is expected that beneficiaries representing the social aspect of the enterprise have some representation towards the development and growth of the business.



- Will a membership be established where members nominate directors/trustees to make decisions on their behalf?
- Will the enterprise not have a membership but a select number of directors/trustees to oversee the enterprise?

- How much control will the entrepreneur or manager on a day-to-day basis require or want or need?
- Will the directors/trustees require remuneration from the start or at some time in the future?
- Will the enterprise be representative of its beneficiaries at board level?
- Will the enterprise be governed by shareholders who have a financial and / or social interest in the enterprise?

TIP – *Establish whether you envisage members having a financial stake in the enterprise.*

What happens to the Assets?



To assist with identifying the most appropriate legal structure, one of the key areas to understand is what happens to the assets. For some social enterprise structures, it is expected that asset lock provision is required.

Under the asset lock provisions, assets and profits must be permanently retained within the company and used solely for community benefit or transferred to another organisation which itself has an asset lock, such as a charity, or a CIC. Other legal structures can include this provision within the Articles of Association.

Will the assets be owned and retained for the benefit of the community?

Who will you nominate to receive your assets? Named or open?

TIP – *Consider initial/pre-start capital provision of equipment – donations or at cost – and who initially owns them?*

– *Gain clarity and understanding of asset ownership – ‘belonging’ or ‘loaned’ to the enterprise.*

Legal Structures for Social Enterprise

1) Company Limited by Guarantee (CLG)

This is the most popular legal structure for a social enterprise and is generally the simplest form whereby directors may be paid.

The enterprise may register as a charity if it meets the Charity Commission's criteria. If they are a charity with company limited by guarantee status they are often described as charitable companies.

Membership

- There may be a membership where members vote in representative members as directors/trustees on the board or no membership where the members are the directors/trustees on the board
- Members can be either 'individual' members or an 'organisation' member

Governance

- The rules define the trading and social objectives of the company, the limited liability guarantee for directors/trustees and that profits / surpluses will not be distributed to directors/trustees but remain within the company
- The rules also identify the voting rights of the directors/trustees and how this relates to the membership
- The company is governed by the Companies Act 2006
- Rules are set out in the Articles of Association specifically for this type of company

Assets

- Assets can be locked but would need drafting into the Articles of Association

Directors

- 75% majority required by the directors/trustees on key decisions (e.g. appointing new directors/trustees)
- Only one director required by law. Generally, the enterprise requires at least 3 directors, with 2 out of 3 being unrelated to be eligible for support from some funders
- Most directors/trustees will volunteer their time and skills, but some can be paid (it is recommended that paid directors are in the minority)

Shares

- Liability is limited to the "guarantee" of usually £1

TIP – Limited by guarantee – there are no shareholders, only ‘members’, who are bound by a guarantee in the articles of association, usually to pay £1 should the company accrue debt. Suitable for not-for-profits.

2) Company Limited by Shares (CLS)

This is not a very common legal structure for social enterprises. In general terms, the CLS structure is where directors of the company have the opportunity to be shareholders that have a financial investment in the company.

Many funders do not recognise this structure as appropriate to apply for grant funding.

Governance

- The company is governed by the Companies Act 2006
- Rules are set out in the Articles of Association specifically for this type of company. The rules define the liability of the shareholders, how the shares are distributed, if any shares are locked or have the ability to be sold and / or transferred and when dividends will be paid out
- The rules also identify the voting rights of the shareholders
- Assets can be locked but would need bespoke drafting in the Articles of Association.

Assets

- Assets can be locked but would need bespoke drafting in the Articles of Association.

Directors

- Only one director required by law. Generally, the enterprise requires at least 3 directors, with 2 out of 3 being unrelated to be eligible for support from some funders

Shares

- The majority of shares are held by organisations or members from the third sector (e.g. social enterprises, charities, and voluntary or community organisations). This differentiates the social enterprise structure from a commercial company limited by shares
- Employees may have shares but this is slightly complicated as usually they are unable to directly benefit from payment of dividends. A trust fund or non-financial means are usually the alternative to providing this benefit
- Liability is limited to the amount of the share the shareholder holds

TIP - It is recommended that legal advice is sought to ensure this not only suits the ethos of the organisation but is legally set up correctly. Due to the potential

complexity of this share option it would require additional consideration and clarification, prior to incorporation, due to potential tax implications for employees receiving dividends and regarding shares held on trust.

- Limited by shares – once the shares are fully paid for by shareholders, their liability to the company is satisfied. If shares are issued unpaid, when the company ceases trading, only the monetary value of any unpaid shares can be demanded by the organisation of shareholders.

3) Community Interest Company Limited by Guarantee (CIC CLG)

This company is incorporated as a Company Limited by Guarantee but with a CIC overlay, so it must satisfy a community interest test. It must apply to the CIC Regulator to register as a CIC, but it is still required to go through Companies House as part of the initial administration process. A CIC is not eligible for charitable status.

Membership

- As with Company Limited by Guarantee

Governance

- As with Company Limited by Guarantee
- The company must satisfy a Community Interest Test
- An annual Community Interest Report must be submitted to the CIC regulator stating how objectives have been met and detailing distribution of profit/surplus (the added regulation ensures that the community benefits from the company's activities and assets)

Assets

- Assets are locked which must be included in the Articles of Association

Directors

- Only one director required by law. Generally, the enterprise requires at least 3 directors, with 2 out of 3 being unrelated to be eligible for support from some funders

Shares

- CLG version of the CIC does not allow for share dividends to be paid – profit cannot be distributed, however, donations could be made to charities

4) Community Interest Company Limited by Shares (CIC CLS)

This company is incorporated as a Company Limited by Shares but with a CIC overlay, so it must satisfy a community interest test. It must apply to the CIC Regulator to register as a CIC, but it is still required to go through Companies House as part of the initial administration process. These companies are not eligible for charity status unless they cease to be a CIC and can then revert/change their status, although this could prove more difficult due to the ownership of shares.

Some funders do not recognise this legal structure as appropriate for grant funding.

Membership

- As with Company Limited by Guarantee

Governance

- As with Company Limited by Guarantee
- An annual Community Interest Report must be submitted to the CIC regulator stating how objectives have been met and detailing distribution of profit/surplus (the added regulation ensures that the community benefits from the company's activities and assets)

Assets

- Should the company cease to trade the assets revert to the organisation named in the Articles of Association.
- Assets are locked which must be included in the Articles of Association

Directors

- Only two directors required by law. Generally, the enterprise requires at least 3 directors, with 2 out of 3 being unrelated to be eligible for support from some funders

Shares

- Limited by Shares with liability limited to the amount of shares
- Profit distribution is subject to a cap, currently 35% maximum

TIP - It is recommended that due to the potential complexity of this share option it would require additional legal consideration and further clarification, when creating the articles; specifically, for clarity on potential loss of initial investment and taking into account the asset lock beneficiaries, if the company ceases to trade.

5) Charitable Incorporated Organisation (CIO)

This is a new legally incorporated structure for charities which registers the organisation with the Charity Commission who give them a charity number. The Charities Act 2011 created this legal form. These organisations are unable to issue shares.

There are 2 types of CIOs; foundation and association, which differ only in who are voting members.

This legal structure allows charities to trade (selling goods or services), whilst still benefitting from tax breaks and gift aid. There are fewer onerous reporting and accounting requirements, and you have more funding options than a CIC or a CLG.

Membership

- Foundation CIOs only allow charity trustees to be voting members
- Association CIOs allow wider voting membership other than just charity trustees
- Members have limited liability

Governance

- Minimum of one trustee
- Charity Commission recommends there is not a mixture of individual and corporate trustees
- CIO law on governance procedures is flexible
- Must submit accounts to the Charity Commission

Assets

- Existing charitable companies can convert to a CIO and transfer assets

Directors

- Trustees have limited liability
- Staff are unable to be trustees

6) Community Benefit Society (CBS)

The Co-operative and Community Benefit Societies Act 2014 splits the legal business structure 'Industrial Provident Society' with two new legal forms; one of which is a Community Benefit Society. These organisations trade in order to benefit the wider community. They can become 'exempt charities', providing they have purely charitable objectives and an asset lock, and will report to the FCA (Financial Conduct Authority) instead of the Charity Commission. This will allow them to receive public grants and charitable trust funds.

Membership

- Membership open to anyone who supports the company's purpose (minimum of three members)
- Members can be either 'individual' members or an 'organisation' member

Governance

- The organisation is run primarily for the benefit of wider society rather than just the members
- Democratic governance with one-member-one-vote, but can be registered with a parent body in control if suitable
- Governing body is known as the 'committee of management' instead of the board

Assets

- The company can choose to have a statutory asset lock which is the equivalent of an asset lock for a charity or a CIC

Directors

- Director appointment or removal does not have to be reported to the FCA

Shares

- Shareholders can earn interest on their shares, however they are not permitted to receive dividends
- £100,000 limit on individual shareholdings
- Liability is limited to the shares the shareholder holds

7) Co-operative Societies

The other legal structure that the Co-operative and Community Benefit Societies Act 2014 creates is a co-operative. These organisations trade for the mutual benefit of their members and may or may not be social enterprises. They cannot register as charities.

Membership

- Open membership - anyone who meets the criteria of the company can become a member (workers are usually members)
- Investors can become members even if they do not use the services of the organisation
- Members can be either 'individual' members or an 'organisation' member (minimum of three members)

Governance

- Run for the mutual benefit of members of whom use its services; to serve their economic, social and cultural needs
- Democratic governance with members active in decision making
- Governing body is known as the 'committee of management' instead of the board

Assets

- Co-operatives cannot currently opt to have a statutory asset lock

Directors

- Director appointment or removal does not have to be reported to the FCA

Shares

- £100,000 limit on individual shareholdings
- Liability is limited to the shares the shareholder holds
- Interest can be paid on shares and dividends from a share of the business's surplus (based on the number of transactions)

8) Unincorporated Associations

This form of organisation is quite informal where a group of people make their own rules for running the organisation and set these as a democratic constitution on behalf of any members the organisation may have. Unincorporated associations have no separate legal identity to the members.

Membership

- Criteria is set out in the constitution as to who can become a member
- Members are liable for any debts incurred

Governance

- Members are liable for any debts incurred
- Not required to be registered with Companies House
- Only have to report to Charity Commission if they register as a charity
- A management committee is usually elected to manage the company decision making

Assets

- Although an unincorporated association can trade and carry on commercial activity, the organisation cannot own property
- It may be able to set up a trust to legally hold ownership of a property and assets for the community.
- Assets are the responsibility of the members

Directors

- Management committee members are elected

Shares

- Not applicable for this structure

This form of organisation is unlikely to offer a long-term solution (although it could be useful to test trading initially) if you are intending to sign contracts or expand the enterprise. You should consider incorporation if you intend to:

- Take on employees
- Raise finance, apply for grants etc.
- Issue shares
- Enter into large contracts
- Take on a lease or buy freehold property

Information on Trusts

A trust is a legal device which governs how assets given by an individual or organisation are to be used. Many organisations such as those involved in education, healthcare, providing advice and conservation, can be structured as trusts.

These are unincorporated bodies and do not distribute their profits. They are managed by trustees. Trustees do not benefit from the trusts, but act on behalf of the community for whose benefit it is set up.

Trusts make their own governing rules and have no legal identity of their own. They have a trust deed which protects their social objectives. It lists the intended beneficiaries and the conditions under which the trust's assets may be used. They can act as sister bodies to unincorporated associations.

Trusts do not meet the eligibility criteria for social enterprise as they are not established to trade.

Differences between a Charity and Social Enterprise

The main difference between a charity and a social enterprise is the trading and income generation.

Charity	Social Enterprise
<ul style="list-style-type: none">•Main goal is to complete a social mission•Governed by charity law (maintained by Charity Commission) which limits trading trading/ income generating activities•Primary trading purpose must be stated in the governing document•Level of trading decided by the Charity Commission on an individual basis•Can have a separate 'trading arm' (Charity Commission explain this further)•Assets always to be used for charitable purposes•Any profit cannot be paid out to members•Cannot issue shares	<ul style="list-style-type: none">•Main goal is to complete a social mission•Can have charitable status (if it has a purely charitable purpose and directors aren't working in it)•No Charity Commission trading restrictions (if not a charity)•Flexible provisions around reinvesting profit•Flexibility in raising capital and repaying investors•Directors and founders can be paid for their work•Should be making a profit•Not legally required to have a 'charitable purpose'•Trading (selling goods or services)

Where to go for further information

- CIC accreditation organisation - <https://www.socialenterprisemark.org.uk>
- Co-operatives UK <https://www.uk.coop/uk>
- Financial Conduct Authority <https://www.fca.org.uk>
- Government Website (incl. companies house, CIC regulator, Charity Commission) <http://www.gov.co.uk>
- School for Social Entrepreneurs <https://www.the-sse.org>
- SEE Ahead – business support <https://seeahead.co.uk>
- Social Enterprise UK <https://www.socialenterprise.org.uk>
- Social Enterprise Yorkshire & Humber <https://seyh.org.uk>
- Social Value UK – member-led social enterprise impact management <http://www.socialvalueuk.org>
- UnLtd – social enterprise support <https://www.unltd.org.uk>



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