

Legal structures for the development of community projects and initiatives

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Introduction

This document is intended to provide an introduction to various legal structures which are commonly used by community groups for the development of community projects. It covers the following organizational types:

- ▶ Industrial Provident Societies (IPS)
- ▶ Community Interest Companies (CIC)
- ▶ Co-operatives
- ▶ Charities
- ▶ Charitable incorporated organization (CIO)

Other legal forms such as Partnerships and Limited Companies which are commonly used for other types of organization are not included in this document.

Industrial Provident Societies (IPS)

What is an IPS?

An industrial and provident society is an organization conducting an industry, business or trade, either as a co-operative or for the benefit of the community, and is registered under the Industrial and Provident Societies Act 1965.

Legal status

An IPS is incorporated. This means that it is a legal entity in its own right. To become incorporated new or existing businesses will need to go through a registration process.

Regulation

An IPS is regulated by the Financial Services Authority.

Governance

IPS's are governed by rules. Various federal bodies have developed model rules which can be adapted to meet the particular requirements of an IPS.

Types of IPS

IPSs fall into two categories:

- ▶ **Bona fide co-operatives** - these trade for the mutual benefit of their members. The legality of their actions will be judged by reference to co-operative principles (see below); and
- ▶ **Societies for the benefit of the community** - these trade to benefit the broader community, and do so with reference to charity law. Societies for the benefit of the community are granted charitable status by the taxation authority, HM Revenue & Customs.

What business activities can an IPS undertake?

IPSs may in general conduct any legal business except that of investment for profit.

Shares

Both types of IPS have a share capital, but it is usually *not* made up of equity shares like those in a company limited by shares, which appreciate or fall in value with the success of the enterprise that issues them. Rather they are par value shares, which can only be redeemed (if at all) at face value.

The profits and losses of an IPS are thus the common property of the members. The share typically acts as a 'membership ticket', and voting is on a 'one member one vote' basis. The maximum individual shareholding is currently set at £20,000 (although other IPSs may hold more shares than this).

Liabilities

The limited liability does not protect individuals that act negligently, improperly, fail to meet obligations under company law or trades without sufficient assets to cover debts, etc.

Key features of an IPS

An industrial and provident society has:

- ▶ a written set of rules;
- ▶ a legal identity;
- ▶ the ability to own property;
- ▶ the ability to enter into contracts;
- ▶ additional legal requirements e.g. company law;
- ▶ limited liability (i.e. the liability on management committee members is usually limited to a nominal amount);
and
- ▶ a profit-making ability, which is put back into the organization.

Examples

Community businesses, agricultural and housing cooperatives, markets, allotment societies, mutual investment companies, friendly societies and housing associations may all incorporate as an IPS.

Bath and West Community Energy is an IPS.

Information sources

Volunteer Now, Belfast, BT7 1SH. <http://www.diycommitteeguide.org/>

Financial Services Authority. www.fsa.gov.uk

Community Interest Company (CIC)

What is a Community Interest Company?

A community interest company (CIC) is a limited liability company with special additional features created for the use of people who want to conduct a business or other activity for community benefit and not purely for private advantage.

The CIC is a relatively new legal structure, designed to meet the needs of social enterprises and 'not-for-profit' projects, which combine the pursuit of a social purpose with commercial activities.

Community interest companies *cannot* also be charities, but the structure provides recognition of the organization's 'not for personal profit' status and community benefits, whilst providing greater flexibility than charitable status.

Ensuring that a CIC qualifies for this special status is achieved by a 'community interest test' and 'asset lock', which ensure that the CIC is established for community purposes and the assets and profits are dedicated to these purposes.

The other key feature of a CIC is a 'dividend cap'. This limits dividend payments to shareholders to ensure profits are applied to the benefit of the community.

Legal status

A community interest company is incorporated.

Liabilities

A community interest company shares many of the features of a limited company in that it is incorporated and the financial liability of its Directors is limited to a nominal amount.

Registration and regulation

Registration of a company as a CIC has to be approved by the Regulator who also has a continuing monitoring and enforcement role. The Companies Act 2004 established the Regulator as an independent public office holder appointed by the Secretary of State for Business, Innovation and Skills.

The Regulator is an independent official and her powers are set out in the Act and the Community Interest Company Regulations 2005.

Governance

The governing document for a CIC is the Memorandum and Articles of Association.

Asset lock and the dividend cap

Asset lock

"Asset Lock" is a general term used to cover all the provisions designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.

A transfer of assets must satisfy certain requirements meaning that, subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must satisfy one of the following requirements:

- ▶ It is made for full consideration (i.e. at market value), so that the CIC retains the value of the assets transferred;
- ▶ It is made to another asset-locked body (a CIC or charity, a permitted industrial and provident society or non-UK based equivalent) which is specified in the CIC's Articles of Association;

- ▶ It is made to another asset locked body with the consent of the CIC Regulator; or
- ▶ It is otherwise made for the benefit of the community.

With only very limited exceptions such as the payment of dividends and the return of paid up capital on liquidation, a CIC's assets cannot be returned to its members unless they are themselves asset locked bodies.

Dividend cap

The dividend cap strikes a balance between encouraging people to invest in CICs and the principle that the assets and profits of a CIC should be devoted to the benefit of the community. This helps to ensure that the dividends are not disproportionate to the amount invested and the profits made by the company.

The cap has three elements:

- ▶ The maximum dividend per share limits the amount of dividend that can be paid on any given share. The limit for shares issued on or after 6 April 2010 is 20% of the paid-up value of a share.
- ▶ The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- ▶ The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is 5 years.

When might a CIC be appropriate?

A community interest company is usually appropriate where some or all of the following apply:

- ▶ The company's profits are to be used for the benefit of the community (or channelled into a charity);
- ▶ Its purpose, activities and beneficiaries meet the Community Interest Test (its activities do not involve political campaigning or support for political campaigning);
- ▶ Its purposes are not exclusively charitable;
- ▶ The company wants more commercial freedoms than offered by charity law (e.g. paying dividends to shareholders or paying board members).

Examples of CICs

Waste recycling, day care centres, local transport provision.

Information sources

Volunteer Now, Belfast, BT7 1SH. www.diycommitteeguide.org

Department of Business Innovation and Skills, www.bis.gov.uk

Co-operative

What is a co-operative?

A co-operative is a business that is jointly owned and democratically controlled by its members.

Co-operatives are trading enterprises, providing goods and services and generating profits, but these profits are under the control of the members, who decide democratically how the profits should be used.

Co-operatives use their profits for investing in the business, in social purposes, in the education of members, in the sustainable development of the community or the environment, or for the welfare of the wider community.

Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity.

Governance

Co-operatives are based on seven principles agreed by the International Co-operative Alliance:

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

Types of co-operative

There are several types of co-operative.

- ▶ **Consumer co-operative** - owned and controlled by their customers.
- ▶ **Worker co-operatives** - owned and controlled by their employees.
- ▶ **Community co-operatives** - owned and controlled by people belonging to a particular community (geographical or a community of interest).
- ▶ **Co-operative consortia** - formed by a number of independent businesses, organizations or individuals and owned and controlled by them.
- ▶ **Multi-stakeholder co-operatives** - enterprises that are owned and controlled by their members.
- ▶ **Secondary co-operatives** - enterprises whose members are other co-operatives.

Legal structures

Currently there is no co-operative legal form in the UK, and so organizations wishing to become co-operatives have to choose one of the existing legal forms to begin operation.

Industrial and Provident Society (IPS)

Please see above.

Private company limited by guarantee/shares

The limited company legal form is the most well known and is widely used by co-operatives. Company law does not offer any protection of the co-operative principles, but, it is flexible and its governing legislation is accessible and up to date. Private companies limited by shares are prohibited from offering shares to the public, so if the proposed co-operative wishes to raise funds from the public this legal form should be avoided. Companies can be set up very quickly and are registered by Companies House directly, or through Co-operatives^{UK}.

Community interest company (CIC) limited by guarantee/shares

Please see above.

Examples of Co-operatives

- ▶ Forest of Avon Wood Products Co-operative - A co-operative consortium with 50 members (businesses and individuals) working with wood grown in the Forest of Avon and surrounding area.
- ▶ Baywind Energy Co-operative - formed in 1996 to establish a wind farm in Cumbria.
- ▶ Co-operative consortia providing home care services.
- ▶ Co-operatives providing retailing and community services
- ▶ Food and agriculture including food buying groups.

Information sources

- ▶ Co-operatives UK. www.uk.coop

Charities

What is a charity?

The Charities Commission states that an effective charity:

Is clear about its purposes and direction

An effective charity is clear about its purposes, mission and values and uses them to direct all aspects of its work.

Has a strong board

An effective charity is run by a clearly identifiable board or trustee body that has the right balance of skills and experience, acts in the best interests of the charity and its beneficiaries, understands its responsibilities and has systems in place to exercise them properly.

Is fit for purpose

The structure, policies and procedures of an effective charity enable it to achieve its purposes and mission and deliver its services efficiently.

Is about learning and improving

An effective charity is always seeking to improve its performance and efficiency, and to learn new and better ways of delivering its purposes. A charity's assessment of its performance, and of the impact and outcomes of its work, will feed into its planning processes and will influence its future direction.

Is financially sound and prudent

An effective charity has the financial and other resources needed to deliver its purposes and mission, and controls and uses them so as to achieve its potential.

Is accountable and transparent

An effective charity is accountable to the public and others with an interest in the charity in a way that is transparent and understandable.

Types of charity

There are two main charitable structures:

- i. The **charitable trust** (with a Declaration of Trust or Trust Deed as the constituting document) or
- ii. A **charitable company limited by guarantee** (governed by Memorandum and Articles of Association)

Both are equally charities and both provide the full range of charitable objects and powers that may be required. With either structure, the trustees remain subject to general charity law and must always act with appropriate care and must keep within the charitable objects and powers.

Trustees (directors) of a charitable company are subject to the Companies Acts and various company law requirements.

The Trust is simpler to administer and cheaper to establish and operate. The chief attraction of the company structure is that it provides protection for the individual trustees/directors from personal financial liability in some circumstances where trustees of an unincorporated charitable trust would not be protected.

Liabilities

There are two sets of potential liabilities that charity trustees face.

The first is in respect of the duties owed to the charity to act with the necessary care and not to act outside the objects and powers of the charity. If trustees cause a loss to the charity, either through a lack of proper care or by spending money for purposes outside the charity's objects, they can be called upon to refund the charity out of their own resources. This applies as much to directors of a charitable limited company as to the trustees of an unincorporated charity.

The second set of liabilities has to do with potential claims by third parties. Examples of these would be: claim for damages for personal injuries; claim for compensation for unfair dismissal by an employee; claim for breach of contract by a supplier of goods and services (e.g. building contractor on building project); claim for damages in respect of "wrong" counselling advice. It is in respect of these potential claims that protection is afforded to trustees of a charitable company.

In the case of a company, a separate legal entity exists. This means that any debts owed by the company are indeed owed by the company and not by the trustees personally. This assumes that the trustees have not given personal guarantees or entered into contracts in a personal capacity. In the case of a Trust, there is no separate corporate entity, and therefore the debts and potential liabilities of the charity, which cannot be met out of its own resources, can become the liability of the trustees personally.

It should also be noted that in the case of a company, if the directors/trustees continue to trade/operate whilst knowing that the company is insolvent, they can then become personally liable for debts owed by the company.

Holding legal title to property

As a company exists as a separate legal person, title to buildings, stocks and shares, etc., can be held in the name of the company and not in the names of the trustees for the time being. This saves legal costs and fees associated with a change of legal title of land/buildings when Trustees change.

Summary of main differences between charitable structures

Issue	Trust	Company
Personal liabilities	Trustees have potential liability to third parties, and could be liable for breach of trust	Trustees/directors are protected from personal liability to third parties (unless entered contracts, etc., in a personal capacity). Could still be liable for breach of trust.
Holding legal title to property	In names of trustees - cost of transferring title each time trustees change	In the name of company so unaffected by changes of trustees - avoids costs
Formalities	Simpler to operate	Various Companies Acts requirements - quite onerous
Accounting requirements	Slightly less onerous. When income exceeds £250,000 pa, the requirements are virtually equivalent.	Slightly more onerous and complicated, especially at income below £250,000 pa
Set-up costs	Cheaper	More expensive because an application must be made to Companies House and the Charities Commission

Information sources

www.stewardship.org

Charity Commission, www.charity-commission.gov.uk

Charitable incorporated organization

This is a new legal structure which has recently been introduced in England Wales. The CIO was created in response to requests from charities for a new structure which could provide some of the benefits of being a company but without some of the burdens. Existing charities and new organizations can convert to CIOs.

Special features - what is a CIO?

CIOs will differ from other charity forms in the following ways:

- ▶ A CIO is an incorporated form of charity which is not a company
- ▶ Although CIOs will not use company terminology - directors will be called charity trustees - they will be more like company forms than other types of charity forms.
- ▶ As CIOs are always incorporated, they will be separate legal entities and their members will have either no liability or limited liability.
- ▶ CIOs - like Community Interest Companies and community benefit societies - will have their assets locked in for their charitable purposes. They will not be able to distribute profits or assets to their members.
- ▶ Unlike some of the other forms used by charities, CIOs will only register with and report to the Charity Commission, not to Companies House or the Financial Services Authority.
- ▶ A choice of formats and administration will be available to suit organizations of all sizes, with or without a membership structure.

There are two models of CIO; the association model where the members are not necessarily trustees, and the where the foundation model where the members are the trustees.

What will CIOs have to do that is different from or additional to an unincorporated charity?

Many aspects of running a CIO will be the same as other forms of charity, but there are a number of differences and additional obligations on the trustees of a CIO:

- ▶ All CIOs will have to register with the Charity Commission, regardless of their income, even if they have an income of less than £5,000
- ▶ As all CIOs will have to register, a CIO cannot be an exempt charity.
- ▶ A CIO does not come into existence until it has been registered
- ▶ A CIO will have to have a registered principal office situated in either England or Wales
- ▶ All CIOs will have to submit an annual return and accounts to the Charity Commission, regardless of the income of the CIO
- ▶ CIOs will have to keep a register of members and a register of trustees - anyone can ask to see, or be provided with a copy of, the register of trustees

- ▶ The constitution of a CIO must contain certain provisions. The Charity Commission has produced two model forms of constitution for use by a CIO, one for CIOs where the members are not necessarily trustees (the association model) and one for CIOs where the only members are the trustees (the foundation model)
- ▶ amendments to a CIO's constitution will not be valid until they have been registered with us - certain amendments will need our prior consent
- ▶ insolvency law applies to CIOs

Information sources

Charity Commission, www.charity-commission.gov.uk