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Setting up a Social Enterprise:

A Guide to Legal Structures

Which legal structure?

When setting up a social enterprise one of the first things you need to consider is the legal structure through which you will operate. The legal structure will dictate fundamental aspects of how your organisation will function as well as setting out your legal obligations and responsibilities.

There are a number of potential options, from a commercial limited company at one end of the spectrum, to a purely charitable trust at the other end.

The option you choose will dictate whether the directors or trustees are protected (limited liability), whether you can distribute profits (dividends), how you can raise finance, whether you pay tax, who you are regulated by, and whether you can achieve charitable status.

There are advantages and disadvantages to all options. Thought needs to be given to the present and future requirements of your social enterprise to ensure the most suitable structure is chosen.

This guide introduces the different structures available to a social enterprise and includes a table which summarises the key points of each.

Company limited by shares

A company limited by shares is an incorporated organisation set up by shareholders. The shareholders are protected by limited liability, which means their liability to the company's creditors is limited to the share capital they originally invested. The shareholders appoint a board of directors to manage the company.

This is the legal form usually adopted by commercial businesses and it can be either publicly (plc) or privately (ltd) owned. It can raise finance to fund its activities through debt finance (loans) or through equity by issuing shares.

A company limited by shares has no restrictions on trading or the distribution of profits. A company limited by shares is not eligible for charitable status.

The Department for Business, Energy and Industrial Strategy regulates all companies limited by shares. Financial statements and an annual confirmation statement must be filed with Companies House each year.

Company limited by guarantee

A company limited by guarantee is an incorporated organisation set up by members. Members act as guarantors by undertaking to contribute a nominal amount towards the winding up of the company upon cessation of business.

This is the legal form usually adopted by not-for-profit organisations who want the protection of limited liability but without equity finance.

A company limited by guarantee has no restrictions on trading. The distribution of profits may be permitted if a clause is included in the Memorandum and Articles of Association.

The Department for Business, Energy and Industrial Strategy regulates all companies limited by guarantee. Financial statements and an annual confirmation statement must be filed with Companies House each year.

Community interest company (CIC)

A community interest company can be either a company limited by shares or a company limited by guarantee. It differs from a standard company because it must have the specific aim of providing benefit to a community.

Community interest companies are subject to an asset lock which protects the use of the company's assets and caps the amount of dividends that can be paid to shareholders or members. On dissolution the assets must be transferred to another community interest company or a charity.

There are no trading restrictions for a community interest company. It is not eligible for charitable status.

A community interest company has the same reporting requirements as a company limited by shares or guarantee. In addition to this it has to deliver an annual community interest company report on its activities.

This is the legal form usually adopted by social enterprises whose aims are social or environmental as well as financial.

Industrial and provident society

An industrial and provident society is an incorporated organisation set up by members or shareholders. Liability is limited to a nominal amount, or the share capital originally invested. The members or shareholders appoint a management committee to govern the organisation.

This is the legal form adopted by organisations working to either a co-operative model trading for the benefit of its members, or as a society trading for the benefit of the wider community.

An industrial and provident society is not currently eligible to register with the Charity Commission, as it is classed as an “exempt charity”. However it may qualify as “charitable” with HM Revenue & Customs. This means that it is not regulated by the Charity Commission, but can (if eligible) enjoy some of the tax reliefs available to charities.

When the provisions of the Charities Act 2006 fully come into force, certain industrial and provident societies may qualify for charitable status with the Charity Commission. At present there is no proposed timetable for implementation.

There are no restrictions on trading or profit distribution, other than those imposed by its constitution.

Industrial and provident societies have to submit accounts and an annual return to the Financial Conduct Authority (FCA) each year.

Charitable company

A charitable company is an incorporated body (a company limited by guarantee) that also has registered charity status.

The company directors are also the trustees of the charity, and are protected by limited liability.

A charitable company falls under the jurisdiction of both company and charity law.

Charitable companies are subject to limitations on trading, although they can set up a trading subsidiary to undertake trading activities (subject to certain restrictions). Charitable companies are not permitted to distribute profits, and on dissolution the assets must be transferred to another charity.

Charitable companies must report to both Companies House and the Charity Commission. Financial statements and an annual return / confirmation statement must be filed with both authorities each year.

Charitable trust

A charitable trust is an unincorporated body and does not have a separate legal identity. This means that the trustees of the charitable trust are not protected by limited liability, and instead are personally liable.

This is the legal structure usually adopted by smaller grant giving charities that do not have any members.

Charities are subject to limitations on trading, although they can set up a trading subsidiary to undertake trading activities (subject to certain restrictions). Charities are not permitted to distribute profits, and on dissolution the assets must be transferred to another charity.

Charities are regulated by the Charity Commission. Financial statements and an annual return must be filed with the Charity Commission each year.

Charitable incorporated organisation (CIO)

A charitable incorporated organisation is a new legal entity for charities. It has the advantages of limited liability and a separate legal identity, but without the burden of having to register with Companies House as well as the Charity Commission.

The introduction of CIOs is being phased in over several years. The first applications for new CIOs were accepted from December 2012. At the time of writing, applications for CIOs were only being accepted for brand new CIOs (not conversions from existing charitable companies).

Unincorporated charitable trusts cannot convert to a CIO. Instead they must set up a brand new CIO and transfer the assets and undertakings of the old charitable trust to the new CIO. Exempt charities, including Industrial and Provident Societies, cannot convert to a CIO, however they may be able to set up a brand new CIO and transfer their assets and undertakings over (subject to eligibility).

CIOs are regulated by the Charity Commission and fall under the jurisdiction of charity law. Financial statements and an annual return must be filed with the Charity Commission each year.

Summary table

	Company Limited by Shares	Company Limited by Guarantee	Community Interest Company	Industrial & Provident Society	Charitable Company Limited by Guarantee	Charitable Trust	Charitable Incorporated Organisation
Regulated by	BEIS	BEIS	BEIS	FCA	BEIS & Charity Commission	Charity Commission	Charity Commission
Governing body	Shareholders	Members	Shareholders / Members	Management Committee	Members / Trustees	Trustees	Trustees
Limited liability	Yes	Yes	Yes	Yes	Yes	No	Yes
Eligible for charitable status	No	Yes (becomes a charitable company)	No	No	Yes	Yes	Yes
Profit distribution permitted	Yes	Yes	Yes / No (determined by articles)	Yes / No (depends whether charitable per HMRC)	No	No	No
Asset lock	No	No	Yes	Yes (can be written into rules if required)	Yes	Yes	Yes
Trading limitations	No	No	No	Yes / No (depends whether charitable per HMRC)	Yes	Yes	Yes

About Us

Godfrey Wilson is a firm of accountants and auditors specialising in charities and social enterprise. For more information please visit our website or contact us for a chat.

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