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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.

The term Social Enterprise was established by the social entrepreneurs of the nineteenth century, the philanthropic businessmen and industrialists who had genuine concern for the welfare of their employees.

# 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, Innovation and Skills (BIS) regulates all companies limited by shares. Financial statements and an annual return 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.

A company limited by guarantee is eligible for charitable status. This is achieved by registering the company with the Charity Commission, however this means that the organisation must report to both Companies House and the Charity Commission.

The Department for Business, Innovation and Skills (BIS) regulates all companies limited by guarantee. Financial statements and annual returns must be filed with Companies House (and the Charity Commission, if applicable) each year.

To qualify for charitable status a body must be established in UK law for charitable purposes only and those purposes must be for the public benefit. If a body has a purpose which is non-charitable, such as political activity, it will not qualify for charitable status, even if it is for public benefit.

# 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.

Social enterprises can be partnerships between local authorities, businesses and other stakeholders working for the community's benefit – for example, in operating day care centres, out of hours GP care, waste recycling, local transport or the provision of low-cost work units for start-up businesses.

# 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 for charitable status, however it may qualify as an “exempt charity” with HM Revenue & Customs. When the provisions of the Charities Act 2006 fully come into force, certain industrial and provident societies may qualify for charitable status.

There are no restrictions on trading or profit distribution, unless it is deemed and “exempt charity”.

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

# Charitable trust

A charitable trust is an unincorporated body and does not have a separate legal entity. 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.

The word charity comes from the Latin word caritas meaning preciousness. It became the standard translation of the Greek word agape meaning an unlimited kindness and loving to all.

# Charitable incorporated organisation (CIO)

A charitable incorporated organisation is a proposed new legal entity for charities only. It will have the advantages of limited liability but without the burden of having to register with Companies House as well as the Charity Commission.

This legal structure will be used by organisations who are currently companies limited by guarantee with charitable status.

The CIO status is expected to become available to charities from late spring 2011.

## Summary table

	Company Limited by Shares	Company Limited by Guarantee	Community Interest Company	Industrial & Provident Society	Charitable Company Limited by Guarantee	Charitable Trust
Regulated by	BIS	BIS	BIS	FSA	BIS & Charity Commission	Charity Commission
Governing body	Directors	Directors	Directors	Management Committee	Directors / Trustees	Trustees
Limited liability	Yes	Yes	Yes	Yes	Yes	No
Eligible for charitable status	No	Yes	No	No	Yes	Yes
Profit distribution permitted	Yes	Yes	Yes / No (determined by articles)	Yes / No (depends whether "exempt charity")	No	No
Asset lock	No	No	Yes	Yes (can be written into rules if required)	Yes	Yes
Trading limitations	No	No	No	Yes / No (depends whether "exempt charity")	Yes	Yes

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