Plunkett Foundation

Improving rural lives together

A Brief Guide to Legal Structures

For Community Co-operatives

March 2016

Introduction

This guide will help you to select the most suitable legal structure for your community co-operative.

Before trading, a community group has to 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 four main choices available to a community-owned business are as follows:

- Community Benefit Society
- Co-operative Society
- Community Interest Company – usually with a large membership
- Company Limited by Guarantee.

More information about choosing a legal structure is provided in this publication. However, it is recommended that legal advice is obtained if you are not clear about the direction you should take.

Starting out

When creating a community co-operative, 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 co-operative 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 a goal in sight. At this early stage, some groups chose 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.

Once incorporated, the benefits of incorporation are:

- The co-operative becomes a legal entity in its own right shifting 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 co-operative can borrow money and receive grants
- There is reduced risk which is equally distributed amongst members.

Plunkett Foundation recommends that a community co-operative 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

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 Co-operative 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 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.

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 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 carry a right to tax relief from HMRC. It is advisable to seek further advice from Plunkett Foundation 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.

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 Foundation'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
Costs £310 for Plunkett members using FCA approved rules

Although this is our favoured model, a community group should look at all of the options available and decide which legal structure offers the best fit with purposes of the enterprise.

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 Co-operative Society
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
Apply to Co-ops UK http://www.uk.coop/

Companies 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 they 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

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 and 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.

Key features of a CIC
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
Quick and easy to establish through https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies

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 Foundation 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.

We can register your legal structure as a Community Benefit Society for a cost of £310 for members of Plunkett Foundation. 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, on-going support once registration has taken place and all administrative costs to set up,. It also includes liaison with the FCA during the registration process. You can find out more about additional benefits for Plunkett members on our website http://www.plunkett.co.uk/

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 CBSs 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.

Could my community enterprise be registered as a charitable incorporated organisation?

A CIO allows a registered charity to trade, is registered by the Charity Commission and is subject to charity law. 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.

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.

Could my community enterprise be registered as a charitable community benefit society?

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. 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. A CCBS that wishes to trade to make a profit may also want to consider a trading arm.

Does all of this apply to groups in Scotland and Northern Ireland?

In principle, yes, however there are 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 on Charity Commission for Northern Ireland - www.charitycommissionni.org.uk

or Co-operative Alternatives on www.coopalternatives.coop

Further information can be provided by:

Charity Commission for Northern Ireland - www.charitycommissionni.org.uk

Co-operative Alternatives (NI) - www.coopalternatives.coop

Communityshares.org.uk - www.communityshares.org.uk

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

OSCR - http://www.oscr.org.uk/

HMRC - www.hmrc.gov.uk

Companies House - www.companies-house.gov.uk

FCA - www.fca.org.uk/

Plunkett Foundation - www.plunkett.co.uk

The CIC Regulator - cicregulator@companieshoude.gov.uk - check

Development Trust Scotland - www.dtascot.org.uk/

Community Shares Scotland - http://communitysharesscotland.org.uk/

Co-operatives UK - www.cooperatives-uk.coop

About Plunkett Foundation

Plunkett Foundation helps communities to take control of their challenges and overcome them together. We support people, predominantly in rural areas, to set up and run life-changing community co-operatives; enterprises that are owned and run democratically by large numbers of people in their community. They help people to tackle a range of issues, from isolation and loneliness to poverty, and come in many forms including shops, cafes, pubs and land-based initiatives, and everything in between.

Our core values are the values of the great Irish co-operative pioneer, Sir Horace Plunkett, who founded the Plunkett Foundation in 1919. He believed that rural communities didn't have to wait for someone else to make life better for them; they had the potential to do it themselves – with a little help. His values are embedded in the heart of what we do:

- We seek economic solutions to create social change
- We seek solutions that enrich rural community life
- We see self-help as the most effective way to tackle rural needs

We use a unique combination of approaches to help communities. We call it 'The Plunkett Way', and it is made up of four stages that we term Inspire, Explore, Create and Thrive:

- We Inspire communities to realise the potential they have within themselves of tackling the issues they face. We do this in a number of different ways, for example by proactively promoting the co-operative approach through national and local media work or hosting and attending community events.

- We then help communities Explore different ways of addressing their specific needs, which could be by visiting existing examples.

- Our expert team then works with the community to help them Create their co-operative, drawing on our wealth of knowledge and experience, as well as our specially-developed tools and resources.

• Once up and running we help the community to make sure their co-operative Thrives by continuing to support them through our membership scheme, by representing their views to governments, funders and other support organisations, or helping them to address another issue by setting up another co-operative.

We work largely in the UK, but also increasingly in Ireland. We also, at times, help to support the development of community-owned co-operatives outside of the UK and Ireland. We're an active member of the international co-operative movement and proud members of the International Co-operative Alliance, the International Agricultural Organisation Society, Co-operatives Europe and Co-operatives UK.