Social Ventures: Which legal structure should I choose?
This Guide is an overview only, which is intended to help social entrepreneurs to select the most appropriate legal structure for their social venture. This Guide reflects the law in force in England and Wales as at 1 July 2016. The Guide is general in nature and may not apply to the particular factual or legal circumstances which a social venture faces, and we therefore recommend that independent legal advice is sought. The Guide does not constitute legal advice and should not be relied on as such.
COMMUNITY INTEREST COMPANY

AT A GLANCE

SUMMARY

A community interest company is a limited liability company, designed for social ventures that want to use their profits and assets for the public good

ADVANTAGES

✓ Clear social purpose identity makes it evident that the venture has a social element which could be useful in attracting impact investors and assessing eligibility for grant funding

✓ Protection of assets - asset lock means the community interest company’s assets and profits must be retained within the community interest company or transferred to another organisation with an asset lock (normally another community interest company or a charity)

✓ Benefit of the community rather than private gain. On a winding up the community interest company’s assets must be transferred to another asset locked body i.e. so that the assets remain for the benefit of the community

✓ Ability to issue shares may make this structure attractive to external investors, subject to the dividend lock and asset lock

✓ Separate legal entity therefore liability of shareholders for the debts of the company are limited to the amount paid for shares

✓ The social mission is embedded in the constitution of the venture

✓ Business investors in community interest companies are eligible for Social Investment Tax Relief (‘SITR’) for both debt and equity funding
Details of the CIC regulatory regime are set out in CAICE 2004 (as amended) and in the Community Interest Company Regulations 2005 (the Regulations) as amended by the Community Interest Company (Amendment) Regulations 2009 (2009 Regulations), the Community Interest Company (Amendment) Regulations 2012 (SI 2012/2335)(2012 Regulations) and the Community Interest Company (Amendment) Regulations 2014 (SI 2014/2483)(2014 Regulations).

**DISADVANTAGES**

- As it is still a relatively new structure, some investors may be unfamiliar with community interest companies
- Capped dividends and the asset lock mean there is limited return for investors
- Additional layer of regulation compared to limited companies by virtue of having to comply with the community interest company Regulations, which includes submitting an annual report to the community interest company Regulator, who has wide powers to regulate community interest companies
- Reporting obligations mean financial information may be publicly available

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CASE STUDY

GOODWILL SOLUTIONS CIC

Goodwill Solutions CIC (“Goodwill Solutions”) was founded in January 2008 by UnLtd Award Winner, Mike Britton, and offers bespoke logistics and warehousing solutions. The business has rapidly grown acquiring over 100,000 sq. ft. of storage space and a large network of clients across the UK and EU. It has an annual turnover of over £3 million.

The business aims to help the local community by running projects (such as the Back to Work programme), training ex-offenders, the homeless and disadvantaged youths for employment in the logistics sector. They also supply low cost, high quality furniture to local people and charities.

Having originally formed as a CLS, Goodwill Solutions became a community interest company in 2009. Mike says that he was keen for Goodwill Solutions community interest company to convert from a CLS to a community interest company in order to ensure that the assets of Goodwill Solutions would always be for the benefit of the social mission rather than private gain. The community interest company model was an ideal structure for this purpose, because a fundamental element of a community interest company is that its assets are ‘locked’, meaning that its assets must be retained within the community interest company rather than distributed to its members. Note that a CLS can also achieve an asset lock, but the asset lock of a CLS is contractual in nature and must be included in the articles of association of the CLS (please refer to page 55 of the Guide).
COMMUNITY INTEREST COMPANY

a. OVERVIEW

A community interest company (‘CIC’) is a limited liability company designed for social ventures that want to use their profits and assets for the public good. The difference between a CIC and a CLG or CLS is the specific requirement that all profits are to be made available for the community it is formed to serve.

It is important to note that a CIC cannot be a charity nor a political party, political campaigning organisation or subsidiary of a political party or political campaigning organisation. Charitable entities that convert to CICs will lose their charitable status. A charity, however, may have a subsidiary that is organised as a CIC. A CIC is a more flexible body than a charity.

b. FEATURES OF A CIC

- Not-for-profit limited company (usually limited by guarantee, although it can be limited by shares);
- A CIC can be a newly incorporated company, or it can be converted from an existing company;
- A CIC is subject to the Companies Act and the other usual company governance rules;
- CICs are regulated by the CIC Regulator;[28]
- Profits after payment of capped dividends and interest must be reinvested for community benefit;
- A CIC is flexible as it can take a number of different corporate structures so long as all its activities contribute to providing benefit to the community;
- A CIC must deliver a community benefit and pass the ‘community interest test’ (see below); and
- A CIC is subject to an ‘asset lock’ (see below).

[28] The Regulator is appointed by the Secretary of State (section 27, CAICE 2004) and her powers and duties are set out in CAICE 2004 and the Regulations. The Regulator is to regulate using a “light touch”, create an awareness of CICs generally and to provide guidance and assistance on matters relating to CICs.
c. **COMMUNITY INTEREST**

To become a CIC, a company must pass, and continue to satisfy, the ‘community interest test’. To satisfy the community interest test, a company must show that a reasonable person would consider that its activities are being carried on for the benefit of the community or a section of the community. A section of the community is defined as any group of individuals who share a common characteristic which distinguishes them from other members of the community and a reasonable person might consider that they constitute a section of the community. This does not prevent the CIC from paying its employees, or paying dividends to its shareholders (subject to the limitations described below), but there must also be a wider community benefit to the activities of the CIC.

**d. ASSET LOCK**

A fundamental element of a CIC is that its assets are ‘locked’. This means that assets must be retained within the CIC, and are not to benefit the CICs members, directors, employees or other persons. A CIC may only transfer assets at their market value, unless it is transferring them to another asset locked body or for the benefit of the community it was set up to serve. Assets of a CIC must also be transferred to another asset locked body on winding up, which ensures that the assets remain for the benefit of the community. CICs may also adopt a more stringent asset lock.

A CIC may pay a dividend to its shareholders (who are not asset-locked bodies), unless its articles of association provide otherwise. However, such dividends are subject to a maximum aggregate dividend cap (currently 35% of ‘distributable profits’). This is to protect the principle that the CIC’s assets benefit the community, by ensuring dividends are not disproportionate to the amount invested by the investor or the profit generated by the CIC. Dividends must be approved by either ordinary or special resolution of the shareholders.\(^\text{29}\)

There is also a cap on the amount of interest that a CIC may pay on loans or debentures it issues. The cap seeks to strike a balance between allowing CICs to access investment whilst ensuring that the assets of the CIC continue to be protected for the benefit of the community. The cap is currently limited to 20% of the average amount of the CIC’s debt or sums outstanding under a debenture issued by it during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due.

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\(^{29}\) Ordinary resolutions require the consent of at least 50% of the shareholders entitled to vote, and special resolutions require the consent of at least 75%.
e. Establishing Costs and Documentation

Establishing a new CIC

Establishment of a CIC is similar to that of a limited company. New organisations can register by filing form IN01 and the memorandum and articles of association, together with a form CIC36 (application to form a community interest company), with the registrar at Companies House together with payment of the filing fee (currently £35). Companies House will then forward the form CIC36 to the CIC Regulator.

The CIC Regulator has produced various model memoranda and articles of association that may be used. These can be found at:

https://www.gov.uk/government/publications/community-interest-companies-constitutions

For other useful materials by the CIC regulator and more information on setting up and running CICs, visit https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies.

Converting an existing company to a CIC

An existing company can convert to a CIC by satisfying the CIC Regulator that it meets the CIC requirements. In doing so, it must pass a special resolution amending its articles of association to state that the company is to be a CIC and to ensure that the articles of association comply with the CIC Regulations. It must also pass a special resolution to change the company’s name to include the appropriate CIC designation30. Copies of these documents must be filed with the Regulator, together with a filing fee and a completed form CIC37 (application to convert a company to a community interest company).


Any subsequent change to the articles of association of a CIC will need the approval of the CIC Regulator.

30 Section 33, CAICE 2004.
**f. CORPORATE STRUCTURE**

CICs can be public or private companies limited by shares or guarantee, and are incorporated under the Companies Act.

**g. LIABILITIES**

*Members*

As a CIC is a limited liability company, its members benefit from limited liability. If the CIC is set up as a company limited by guarantee, refer to Section 2.4 for a description of the limited liability of its members. If the CIC is set up as a company limited by shares, refer to Section 2.5 for a description of the limited liability of its shareholders.

*Directors*

The position of the directors of a CIC is the same as that of a company limited by guarantee or company limited by shares. Refer to Section 2.4 or 2.5 for a description of the liability of directors.

**h. TAX TREATMENT**

*Entity*

CICs do not receive tax benefits by virtue of their legal status. A CIC is liable to corporation tax on any trading profits (though it will be a question of fact whether or not a particular CIC is trading) and on its investment income and gains. A CIC is eligible for any reliefs which are available to all companies, but there are no specific tax exemptions/reliefs available.

*Shareholder*

The Social Investment Tax Relief (SITR) scheme applies to investments made on or after 6 April 2014 and before 6 April 2019 and provides investors with income tax relief and an exemption from capital gains tax when investing in social ventures. Investments may comprise of either debt or equity, provided certain conditions are met. The investor may claim income tax relief of 30%, up to an annual investment limit of £1,000,000 (across various social ventures), provided that the investment is held for 3 years. For example, if the individual invested £100,000 into a qualifying social venture, his or her income tax liability would be reduced by £30,000 (30% of £100,000) for that tax year. The investor would also be entitled to an exemption from capital gains tax on any gains made when disposing of the investment, so long as he or she has owned the investment for the requisite 3 years. Additionally, any losses suffered by the investor upon the disposal of shares (but not debt)
can be offset against the investor’s income or capital gains, the net effect of which is to limit the investment exposure of the investor.

For a social venture to qualify for SITR, it must be one of more of the following: (i) a community interest company; (ii) a community benefit society; (iii) a charity (including a charitable trust); or (iv) an accredited social impact contractor. Additionally, there are a number of legislative criteria to be met for qualification under the SITR scheme. These include that the social venture must: (i) be unquoted at the time of investment; (ii) have under 500 full-time employees at the time of investment; (iii) have gross assets of less than £15 million immediately prior to investment (and no more than £16 million immediately after the investment); (iv) utilise the money raised via the investment for the purposes of the social venture’s chosen trade within 28 months of the date of the investment; and (v) not be a 51% subsidiary of another company or under the control of another company (or another company together with persons connected with that other company) or a member of a partnership. The maximum that a social venture may raise over any three year period is £344,827.31.

Please note that the particular circumstances of the social venture, as well as the circumstances of the individual investor, must be considered in detail so as to determine whether the social venture, the individual and the shares qualify for SITR. There is also an approval process to be undertaken with HMRC. You should speak to your tax adviser if you think your social venture might qualify for the SITR scheme.

i. **ONGOING GOVERNANCE AND REGULATORY OBLIGATIONS**

CICs are regulated by the CIC Regulator. The CIC must file a community interest report, known as the CIC34, which is submitted to the CIC Regulator’s office on an annual basis along with a fee. The Community Interest Report must contain:

- a fair and accurate description of the CIC’s activities that have benefited the community;
- details of the consultations with persons affected by the CIC’s activities (if any);
- details of the directors’ remuneration (unless full details are provided in the annual accounts of the CIC);
- the value (or a fair estimate of the value) of any assets transferred for less than full consideration;

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31. This limit could be raised substantially in the near future, subject to EU approval.
• details of dividends declared on shares and compliance with the capping rules set by the Regulations; and
• information on any performance-related interest paid on loans or debentures.

It also has obligations to file accounts and a confirmation statement in the same way as other companies.

The CIC Regulator, an independent public official, has the power to advise, guide, investigate and enforce. CAICE 2004 provides the Regulator with a wide range of enforcement powers.\[32\

### j. FINANCE AND FUNDRAISING

Grants may be available depending on the CIC’s expected activities and the impact of its work. Grants are usually targeted at specific projects and one off capital purchases.

CICs can raise finance through the issuing shares to private investors. However, unlike shares in an ordinary private company limited by shares, shares in a CIC will be limited by the ‘asset lock’, and restrictions on the payment of dividends, which may make returning value on the shares more difficult. This may be unattractive to some potential private investors who are seeking a purely commercial return, but will be a familiar structure for those who are seeking a modest return on their investment but also recognise and support the social purpose of the CIC.

CICs are able to raise capital using all of the main methods of crowdfunding (i.e. donation-based, rewards-based, equity-based and loan-based crowdfunding). Although, for the reasons mentioned above, equity-based crowdfunding might prove more difficult to attain.

Shares in a CIC can also be structured in a way which enables shareholders to attract EIS relief. For more information, please see section 2.5(g).

A CIC may also obtain loan finance, subject to the interest caps referred to above.

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\[32\] Sections 41 – 48, CAICE 2004