PRIVATE COMPANY LIMITED BY SHARES
DISCLAIMER

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.
PRIVATE COMPANY LIMITED BY SHARES

AT A GLANCE

SUMMARY

The most common form of corporate entity, in which the members hold shares in the company.

ADVANTAGES

√ Separate legal entity therefore liability of shareholders for the debts of the company are limited to the amount paid for shares
√ Company can easily enter into contracts and hold assets in its own name
√ Easier to raise certain types of finance: can issue shares to raise capital
√ The social mission can be embedded in the constitution of the social venture
√ Company can have employees and offer share ownership incentives to them if desired

DISADVANTAGES

☒ Ongoing reporting obligations; financial information may be publicly available
☒ For social ventures, constitutional documents may need to be tailored in order to ensure the assets and profits of the company are preserved for the social mission, and to prevent drift from the social mission
☒ Company may not be readily identifiable specifically as a social venture and therefore may not gain the commercial benefit that such identification brings
☒ Unlikely to be eligible for certain grants and other forms of support that are available for charities and other non-profit organisations
CASE STUDY

TALENTINO

Talentino was founded by UnLtd Award Winner, Jenny Connick. It is a young, dynamic, award winning, career development company based in Reading and working across England. Talentino offers two career development programmes and trains people from schools, Special Schools, housing associations, local authorities, children’s homes and businesses to deliver these programmes.

Talentino was established as a company limited by shares because Jenny wanted to reflect the entrepreneurial, business-like approach they were taking to the career development programmes, which she felt were often lacking in innovation and professionalism. The model suited them well, because while it was important to express Talentino’s social values – which they achieved by embedding the social mission in Talentino’s constitution – they did not want to deny their objective to also be successful commercially.

Jenny acknowledges that, for certain funding streams, such as grants, it is a disadvantage to be a company limited by shares, but this depends on where a venture’s income is going to come from, and the specific marketplace it operates in. Talentino generates most of its income through sales and a small proportion from grant funding. Investment funding has come in three forms, revenue participation\(^25\), debt financing and income generated through granting exclusive licensing in exchange for the development, marketing and ongoing maintenance of a new online product.

In addition, Jenny has created a registered charity and granted a free license to it for Talentino’s products. It is still early days but the purpose of the charity is to provide extended career coaching and personal development support that would not be funded commercially.

\(^{25}\) Revenue participation is a type of financial instrument that allows both the investor and investee to share the risk and reward of enterprise more flexibly than debt allows and in situations in which equity financing may not be possible.
PRIVATE COMPANY LIMITED BY SHARES

a. OVERVIEW

A private company limited by shares (‘CLS’) is a type of private company that is often used by for-profit companies. CLSs account for the vast majority of all companies registered in the UK. Although a CLS is principally a ‘for-profit’ legal structure, some social entrepreneurs are increasingly choosing this form for their social ventures.

A CLS has a separate legal identity from that of its shareholders. This means that the company’s finances are separate from the personal finances of the shareholders. This means that, ordinarily, each shareholder’s liability towards the CLS is limited to the amount that they have invested when they became a shareholder of the CLS and the amount, if any, unpaid on the shares held by them. Therefore, save for their investment, shareholders will not ordinarily be responsible for the CLS’s debts simply by virtue of being a shareholder of the CLS.

The governance rules of a CLS are contained in its articles of association which set out the internal management structure and procedures, such as the role of shareholders and directors, procedures for appointment and removal of directors, and conduct of meetings. A form of model governance rules can be obtained free of charge from the Companies House website. You should consult a legal adviser in order to determine whether or not the model rules are suitable for your company without modification or entrenched of the concepts noted above.

One of the main considerations which social entrepreneurs will need to consider when they choose a for-profit legal structure like a CLS is how they will protect the social mission of the CLS. There are various protections a CLS could include in its articles of association to embed the social mission of the venture, and these are described in more detail in section 2.5(c) ‘Protecting the social mission’ below.

A CLS must have at least one shareholder and at least one director. At least one director must be an individual (as opposed to a corporate entity acting as a director) and any individuals must be over 16 years of age, and not subject to any order disqualifying them from acting as a director. Like all private companies, a CLS does not have to appoint a company secretary, but if one is appointed, Companies House must be notified. If a company secretary is not appointed, the traditional role of the company secretary will still have to be performed by someone else, usually a director.
b. ESTABLISHMENT COSTS AND DOCUMENTATION

A CLS can be formed by: (i) incorporating ‘from scratch’ i.e. drafting the incorporation documents specifically to suit the needs of the specific company, or; (ii) buying an ‘off-the-shelf’ company, the documents for which can then be modified. Please see section 2.4 ‘Establishment costs and documentation’ in the section relating to CLGs for further information.

To establish a CLS, the same procedure as set out in section 2.4(b) ‘Establishment costs and documentation’ in the section relating to CLGs must be followed: the memorandum of association, articles of association, form IN01 (application for registration) (except for Part 4 which is only completed by CLGs) and the prescribed filing fee must be lodged with the registrar at Companies House.

The standard fee for paper filing is currently £40 and £13 for electronic filing.

The restriction preventing certain names being registered as set out in the Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2014 also applies. Please see section 2.4 ‘Establishment costs and documentation’ in the section relating to CLGs for further information. For further information and resources in respect of the setting up and running of a CLS, visit http://www.companieshouse.gov.uk.

c. PROTECTING THE SOCIAL MISSION

One of the main considerations which social entrepreneurs will need to consider when they establish a for-profit legal structure like a CLS is how they will protect the social mission of the CLS. In order to resolve this, a social venture which is incorporated as a CLS may wish to consider protecting the balance between its social mission and the requirement to realise a return for its shareholders, by including various protections in its articles of association.

Examples of the protections that could be included in the articles of association include:

- an asset lock – this is similar to the ‘asset lock’ concept which is discussed in section 2.6 in relation to CICs, but is contractual in nature, being set out in the CLS’s articles of association. An asset lock could prohibit the distribution of some or all of the assets/profits of the CLS to its shareholders, so that such surplus of assets/profits can be retained and used for the benefit of the social mission the CLS was established to serve; and/or

- a statement of the objects of the CLS – this would clearly identify the mission of
the social venture and the directors would be bound to act in accordance with this statement of the objects.

As the articles of association of a CLS can usually be amended by a special resolution of the shareholders (i.e. 75% of the shareholders of the CLS), social entrepreneurs may wish to consider taking steps to ‘enshrine’ or make permanent the social mission or asset lock in the CLS’s constitution. One way of doing this is to have a golden share which is held by an independent organisation or individual aligned with the social purpose of the CLS. This golden share may, for example, have the rights to vote on decisions such as a change in the nature of the social mission or any change to the asset lock. A golden share is a nominal share in the CLS which is able to out-vote all other shares in certain specified circumstances. This should provide investors and other funders with comfort that the CLS will not deviate from its social mission. Professional advice should be obtained on these types of structures.

d. LIABILITIES

Shareholders
A CLS is usually incorporated with one class of shares, being ordinary shares, each share having a designated nominal value. This nominal value can be whatever the person incorporating the company chooses, but it is commonly set at £1 or £0.01 per ordinary share. The company may issue shares for any price, provided that it can never be less than the nominal value, whatever that amount may be. Once shares have been issued by the company to a shareholder, that shareholder may sell the shares at any price (even if it is less than the nominal value).

A shareholder’s liability is ordinarily limited to the amount of their investment in the company, i.e. the amount paid for the shares, or if these shares have not been fully paid, the amount unpaid on the shares.

A company may issue different classes of shares to shareholders, each with its own rights, such as rights to vote and to participate in the profits and capital of the company. Different classes of shares may have different nominal values and even different currencies. The benefit of having different share classes is the flexibility to offer different investors shares which suit their needs, for example some investors may require a preferential dividend right.
Directors
The directors of a CLS are generally not personally liable for the debts of a CLS, unless they have voluntarily accepted such liability, for example, by giving a personal guarantee. However, the same considerations as apply to the personal liability of directors of a CLG apply to directors of a CLS.

Please see section 2.4 ‘Liabilities’ in the section relating to CLGs for further information.

e. COMPANY INDEMNIFICATION
A director of a CLS may be indemnified by the company for all liabilities, costs, charges and expenses incurred by him in the execution and discharge of his duties to the company, in the same way as a director of a CLG. Please see section 2.4 ‘Company indemnification’ in the section relating to CLGs for further information.

f. DIRECTORS’ AND OFFICERS’ LIABILITY INSURANCE
It is also possible to take out appropriate directors’ and officers’ liability insurance to cover such potential liabilities. Again, this will only be possible if a company’s articles of association permit this, and normally will only cover situations where the director has made an honest mistake. Please see section 2.4 ‘Directors’ and officers’ liability insurance’ in the section relating to CLGs for further information.

g. TAX TREATMENT
Company
A CLS will be liable to corporation tax on its profits in the same way as a CLG. Please see section 2.4 ‘Tax treatment’ in the section relating to CLGs for further information.

Shareholders
Shareholders must consider their individual tax consequences, which will largely depend on each individual’s circumstances.

In the case of employees, the company should consider whether individual employees should acquire shares or be granted options to acquire shares (and the availability of tax-favoured share option plans) as the tax consequences for each will vary. On the sale of shares in the company the individual is likely to be liable to pay capital gains tax on any gain he or she receives (less the individual’s annual exemption).
Share options are commonly granted to offer equity incentives to a company’s directors and employees in order to recruit talent, and retain and motivate them. These types of incentives are also commonly used to align the interests of employees with those of shareholders. There are also valuable tax advantages to using HMRC approved share options schemes (for example, enterprise management incentive options or company share option plans). Unapproved option schemes may also be put in place to motivate individuals, but do not have the same tax advantages. There are various requirements and criteria for each type of approved option, including criteria relevant to the company granting the option, the individuals being granted options, the shares and certain limitations to the value of options granted. You should speak to your legal adviser in relation to the suitable option schemes available for your company.

In addition, three types of tax relief might be available to qualifying investments in social ventures. These reliefs are designed to encourage investment into smaller, higher risk enterprises, by offering tax relief on new shares in qualifying entities. Typically, these tax reliefs (set out below) would be available to shareholders investing directly into the relevant social venture, provided the social venture is a qualifying entity.

**EIS relief**

The Enterprise Investment Scheme (‘EIS’) provides qualifying investors with income tax relief and the right to defer capital gains tax when subscribing for new ordinary shares in companies that qualify under the EIS. The investor may claim income tax relief of 30%, with the total relief being capped at £1,000,000 per year, provided that the shares are held for 3 years. For example, if the individual invested £100,000 into a qualifying company, 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 those shares, so long as he or she has owned the shares for the requisite 3 years. Additionally, any losses suffered by the investor upon the disposal of the shares 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.

There are a number of criteria to be met for qualification under the EIS scheme. These include that the company must: (i) be unquoted when the shares are issued; (ii) have gross assets of less than £15 million immediately prior to the shares being issued (and no more than £16 million immediately after the investment); (iii) have under 250 full time employees; (iv) generally exist wholly for the purpose of carrying on a qualifying trade; (v) issue the shares within 7 years from the date of the company’s first commercial sale; and
(vi) 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). In addition, there must be no ‘connection’ between the investor and the company (meaning that the investor cannot control or hold more than 30% of the share capital or voting rights, nor be a partner, director, employee or ‘associate’ of the company (with exceptions for ‘business angels’)). The maximum that can be raised under the EIS (together with other venture capital schemes) is £5 million in any 12 month period.

**SEIS relief**

The Seed Enterprise Investment Scheme (‘SEIS’), like the EIS, provides income tax relief and a partial exemption from capital gains tax on gains realised on the disposal of assets that are reinvested through SEIS in the same year (50% relief from 2014/15 tax year onwards). The investor may claim relief from income tax of 50%, with a maximum tax relief per investor per year of £100,000, provided that the shares are held for 3 years. For example, if an individual invested £100,000 into a qualifying company, his or her income tax liability would be reduced by £50,000 (50% 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 those shares, so long as he or she has owned the shares for the requisite 3 years. Additionally, if there is a loss on the investment, those losses 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.

Like EIS, there are a number of criteria to be met for qualification under the SEIS scheme. These include that the company must: (i) be unquoted when the shares are issued; (ii) have gross assets of less than £200,000 immediately prior to the shares being issued; (iii) have under 25 full time employees (and the investor may not be an employee of the company); (iv) generally exist wholly for the purpose of carrying on a qualifying trade; (v) have commenced the trade less than 2 years before the shares were issued; and (vi) must 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). In addition, there must be no ‘connection’ between the investor and the company (meaning that the investor cannot control or hold more than 30% of the share capital or voting rights, nor be an employee of the company). The maximum that can be raised under the SEIS is £150,000.

Please note that the particular circumstances of the company and the company’s group, as well as the circumstances of the individual, must be considered in detail so as to determine whether the company, the individual and the shares qualify for either EIS or SEIS relief. A
company that has raised money under the EIS scheme cannot then raise money under the SEIS scheme. 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 EIS or SEIS.


**SITR relief**

The Social Investment Tax Relief (‘SITR’) scheme provides investors with income tax relief and an exemption from capital gains tax when investing in social ventures. Please see section 2.6 ‘Tax Treatment’ in the section relating to CICs for further information.

**h. ONGOING GOVERNANCE AND REGULATORY OBLIGATIONS**

The ongoing filing requirements for a CLS are similar to the ongoing filing requirements of a CLG. Please see section 2.4 ‘Ongoing governance and regulatory obligations’ for more information.

**i. CORPORATE STRUCTURE**

A CLS will have one or more shareholders who are its owners, and one or more directors who are responsible for the day-to-day running of the CLS. A CLS is governed by its articles of association. Whilst most day to day decisions are taken by the board of directors of the CLS, certain decisions and changes relating to the company will require shareholder approval.

**j. FINANCE AND FUNDRAISING**

A CLS will often raise money through the following methods:

- Issuing shares to investors. In the initial stages, a small company set up by an individual may raise financing from that individual’s savings and/or their family or friends. To help the company grow, additional financing may need to be raised from external investors.

As discussed previously in section 2.5(a) ‘Overview’, shares in a CLS cannot be offered to the public at large. If you wish to offer shares either to the public or a
Social Ventures: Which legal structure should I choose?

A group of investors, including friends and family, you should speak to your legal adviser for further advice.26

• A CLS may look to raise money through a loan. It is important to note that banks and other lenders will nearly always ask to see a business plan before lending and may ask for their money to be secured against some or all of the assets of the company. In some cases they may ask for the directors or shareholders to give personal guarantees, in which case legal advice should be obtained on the implications of this. Loans may also be available from a community development finance institution (‘CDFI’). Please see the following link: http://responsiblefinance.org.uk/ for further information.

• A CLS may also raise money by issuing bonds. These are essentially a promise to pay a certain amount, in addition to interest, to an investor. Bonds are a material instrument that can be bought and sold. If you are considering issuing a bond, you should seek specialist legal advice.

A company may be eligible for grant funding, if for example the business is being set up in a deprived area. Useful information can be found at:

https://www.gov.uk/business-finance-support-finder/search

All the main forms of crowdfunding (including donation-based, rewards-based, equity-based and loan-based crowdfunding) are viable methods of fundraising for a CLS.

k. CERTIFIED B CORPORATIONS (‘B CORPS’)

B Lab is a non-profit organisation set up in the US in 2006 with the aim of creating a global movement of purpose-led entrepreneurs. B Lab established a certification process pursuant to which qualifying enterprises can be certified as a B Corp. B Corps are not a legal form in the UK; rather, they are for-profit businesses that have social and/or environmental impact as part of their mission, and which have met B Lab’s performance, accountability and transparency requirements. In the UK, B Corp certification can apply to any for-profit business, which for this purpose includes those registered as CICs. There are now almost 2000 certified B Corps across the world, including over a hundred in the UK.

B Corp certification may be seen as external validation of a venture’s commitment to its social mission which could help with potential investors, making B Corp certification a

26 Under FSMA, there is a general prohibition against communicating any invitation or inducement to engage in investment activity unless authorised by the FCA. The offer of shares in a private company limited by shares would constitute such a communication and is therefore generally prohibited unless an exemption applies such as a financial promotion to high net worth individuals or ‘business angels’.

potentially attractive option for social entrepreneurs where a social venture wishes to have
the flexibility of using a CLS, but wants to be independently recognised as a mission-led
business.

In order to certify as a B Corp, a business needs to score at least 80 points on the B Impact
Assessment (‘BIA’) and pass a legal test. The BIA adapts according to the sector and
market in which the business operates and surveys several categories such as governance,
workers, community, environment and socially and environmentally-focused business
models to come up with both overall and targeted sub-ratings.

In addition, the UK Legal Test requires any business wishing to become a B Corp to amend
or adopt governing documents which include a commitment to a ‘triple bottom line’
approach to business. In other words, the business would need to have an objects clause
which states that it exists to promote the success of the business for the benefit of its
shareholders but also to have a material positive impact on society and the environment.
The governing documents must also require directors to consider a range of ‘stakeholder
interests’ - including those of employees, suppliers, the community and the environment
- as equal to those of the shareholders when making decisions.27 A full explanation of
the UK Legal Test, with examples of suggested language to be used for the governing
documents, can be found at http://www.bcorporation.net/sites/default/files/documents/
uk/Legal_Test_Final_August_2015.pdf

Any UK business is likely to be eligible for B Corp certification as long as it can prove that it
competes in a competitive marketplace, generates the majority of its revenue from trading
and is neither a charity, nor majority owned by the state. For full certification, the business
must have been operating for over 12 months, however, any start-ups structured as for-
profit businesses can earn temporary ‘Certification Pending’ designation.

B Corps have to pay an annual certification fee which ranges from £250 to upwards of
£50,000 depending on the turnover of the business. The full certification rates, which
are subject to change, are available at http://bcorporation.uk/become-a-b-corp/how-to-
become-a-b-corp/make-it-official-uk.

For more information on the launch of the B Corp certification in the UK, visit: http://
bcorporation.uk/

27 The Companies Act 2006 s172 makes the interests of the members a paramount consideration, above those of other stakeholders.
CASE STUDY

Elvis & Kresse is a socially minded, specialty design house that reclaims waste materials that were otherwise destined for landfill and transforms them into premium-value consumer goods. It was founded by Kresse Wesling, an UnLtd Award Winner, with her partner James (aka Elvis) Henrit. Elvis & Kresse is a CLS and, as of 2015, it is also a certified B Corp.

The CLS was initially established to save London’s decommissioned fire hoses. The now-decommissioned fire hoses become too damaged to use for fire-fighting purposes after approximately 30 years of usage. Elvis & Kresse rescues the decommissioned hoses, scrubs away the decades of soot and grease, and re-engineers the industrial material using quality craftsmanship and classic, timeless design.

Given their business backgrounds, a CLS was the legal structure that Kresse and James were most familiar and comfortable with. The CLS was founded in 2005 through their private efforts and finances.

“CLS is the easiest structure to establish and has known rules,” says Kresse. Although she was aware of other options, including the then newly-introduced CIC structure, she did not feel that, as a self-funded business, they were appropriate.

To further lock in their social mission, Elvis & Kresse decided to apply for certification as one of the founding UK B Corps in 2015. Since becoming a certified B Corp, Elvis & Kresse has actively traded with other B Corps and this has increased sales. Therefore, becoming a B Corp and being able to trade in the B Corp community has proved to be a commercial advantage of B Corp certification.