

Keeping it legal

legal forms for social enterprises

charitable status social ownership stakeholders
incorporation legal forms for social enterprises
raising finance social ownership
limited liability stakeholders charitable status

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Preface

This legal guide booklet is for people who wish to set up and run successful social enterprises. It is aimed at new starts, emerging social enterprises from the voluntary sector and expanding established social enterprises who may be considering changing their legal structure. It is for social entrepreneurs, managers and board members and for those who are involved in helping or supporting them.

What is Social Enterprise?

The term social enterprise is a relatively new one although the concept goes back a long way.¹ Put simply it is about trading with a social purpose, using business tools and techniques to achieve explicitly social aims. The Department of Trade and Industry define a social enterprise as “a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximize profit for shareholders and owners”.²

Social Enterprise London (SEL) identify three common characteristics of social enterprises³:

- **Enterprise orientation** – they are directly involved in producing goods or providing services to a market. They seek to be viable trading concerns, making an operating surplus.
- **Social aims** – they have explicit social aims such as job creation, training or the provision of local services. They have ethical values including a commitment to local capacity building. They are accountable to their

members and the wider community for their social, environmental and economic impact.

- **Social ownership** – they are autonomous organisations with governance and ownership structures based on participation by stakeholder groups (users or clients, and local community groups etc.) or by trustees. Profits are distributed as profit sharing to stakeholders or used for the benefit of the community.

A social enterprise is not defined by its legal status but by its nature: what it does that is social, the basis on which that social mission is embedded in a form of social ownership and governance and the way that it uses the profits it generates through its trading activities. They come in all shapes and sizes ranging from very small local community based organisations, to much larger entities employing thousands of people. They can take on a variety of organisational forms that share common values or ways of working such as co-operatives, development trusts or social firms. They also use a variety of legal structures under the Companies Acts and Industrial and Provident Society legislation. This guide explains how these structures are used and how they provide a framework for social ownership and governance.

Embodying social ownership in a legal structure

Within the legal frameworks that are adopted, a range of ownership structures is used. In some social enterprises, there is a small core of

1 The establishment of the co-operative movement in the 19th Century is clear example of social enterprise in the form of collective self-help through trading activity.

2 'Social Enterprise: A strategy for success', Department of Trade and Industry, 2002.

3 See 'Introducing Social Enterprise', Social Enterprise London, 2001.

individuals who play a role similar to trustees. These 'trustees' fulfil the dual role of members and directors on the board. The trustees receive no personal profit from the business. These enterprises often provide income or employment for the disadvantaged or services to a community. On the other hand, social enterprises such as credit unions or co-operatives have a large number of members who elect the board. These are mutual or self-help organisations. A wide range of models is found between these two, sometimes involving a variety of stakeholders being represented on the board or management committee.⁴

Choosing a legal structure

Choices about adopting a legal structure will depend on a number of factors linked to the nature of the social enterprise – its social purpose, the people/stakeholders who are involved with it, the scale on which it plans to operate and the way its start up and working capital needs are to be financed. What is important is that form follows function, that the choice of legal structure accurately reflects the needs of the social enterprise in question.

Careful planning must take place before the establishment of a new social enterprise or before making changes to an existing enterprise to ensure that the most appropriate legal structure is chosen. Investing time and resources in selecting the right structure is vital and the decisions taken should be based on long-term considerations for the enterprise. Selecting the wrong structure can have disastrous consequences. These may result from problems with governance, such as the exclusion of key stakeholders, the involvement of too many stakeholders or a governance framework out of tune with stakeholders' interests; limitations on mechanisms for investment, or a failure to protect the social nature of the business. For social enterprises that are emerging from the voluntary

sector the question of charitable status will be of particular concern. On the one hand, charitable status offers potential savings in tax and the opportunity to raise additional funds. On the other hand, it places very clear limitations on what the business can lawfully do under charity regulations.

Using the Guide

The guide is a practical first step in acquiring basic knowledge about the options for choosing an appropriate legal structure which will suit the needs of a new or expanding social enterprise. It is not intended to replace good expert advice, rather it sets out some of the choices available, the consequences of making those choices and aims to guide the reader in his or her dealings with lawyers, accountants and other business advisors who are providing advice. It should be noted that the legal structures covered in this guide apply only to England and Wales. Separate law governs the establishment and regulation of social enterprises operating in Scotland and Northern Ireland.

⁴ For a fuller explanation see "Social Enterprise: Organisational Development Issues", Social Enterprise London, 2001 pp7-13.

1 Introduction

1.1 Why are legal forms important?

'Legal form' refers to the way in which a business is set up and the rules and regulations that govern it i.e. it provides the operating framework for an organisation. If the wrong legal form is chosen it can mean future difficulty. Each legal form will establish either a 'corporate' or an 'unincorporated' organisation.

These categories are explained in Chapter 2.

The choice of legal form can depend on a variety of different factors. Legal form tends to become more important as the organisation grows or as not-for-profit branding becomes important.

1.2 Routes into social enterprise

The motivations and context for establishing a social enterprise vary widely. Routes into social enterprise include:

- **Community regeneration** – members of a local community come together to meet a specific need. For example, a group of mothers setting up a nursery for their children or a group of refugees setting up a small co-operative business making clothes. These often begin on a small scale with little focus on formal arrangements.
- **Employee buyout** – employees of a business that is already operating come together to buy out the existing owner. For example, a health food shop that is bought by the staff so that it can be run on a co-operative basis. In this scenario legal form is likely to be considered from the outset.
- **Local Authority externalisation of services** – a local authority transfers one of its services to an independent operation. For example, a community leisure centre is leased to an independent social enterprise and the business and staff are transferred. Another example would be the contracting-out of waste

CASE STUDY 1

Local authority externalisation of services: C.I.T.A.S.

C.I.T.A.S., Community Interpreting and Translation Access Services, was established in July 1999 from the Interpreting and Translation Unit of the former Hammersmith & Fulham Council for Racial Equality.

The Interpreting and Translation Unit had been in existence since 1971. It was a well-established service, used by public sector organisations and the local community. In February 1999, the local authority announced that the funding for the Council for Race Equality, including the Interpreting and Translation Unit, was being

discontinued. The staff were determined to retain the service and launched a campaign in which existing clients and the community were asked for their views on the need for the service. Survey results showed the service was essential.

85% of C.I.T.A.S.'s income comes from trade with the remaining 15% of core funding provided by the local authority. C.I.T.A.S. was created as an independent charity and company limited by guarantee. The service moved premises, but otherwise continued its operation.

collection and re-cycling services. Again, the legal form is likely to be considered at the outset as part of the negotiation process between the council and the new owners.

- **Individual social entrepreneur** – an individual with a particular vision will create a business to meet an identified need, often in an innovative way. A social entrepreneur may set up an organisation which has stakeholder involvement, but the legal form is often secondary to the focus on activity and viability in the early years.
- **Voluntary organisation transformations** – a voluntary organisation which has been funded by donations and grants decides to turn to trading. This may be driven by a desire to ensure its long-term viability, or from a belief that its beneficiaries are better served by the transformation, or perhaps both. For example, an organisation that runs community music workshops for children in the summer holidays decides to enter a contract with a local authority to provide music lessons to schools in the borough for payment. The

implications of such a change in activity on the appropriateness of the legal form can be overlooked.

- **Voluntary organisation spin-offs** – a project green housed by a voluntary organisation may then be transferred to a separate legal entity. For example, a charity sets up a workshop where the long-term unemployed learn how to re-furbish electrical equipment which is then retailed. The business has development potential and is sold as a going concern.

1.3 Stakeholders

Throughout this booklet we discuss ways of involving stakeholders (used in the broad sense to mean those individuals or groups with a particular interest in the organisation). Stakeholder involvement is a central feature of many social enterprises. Stakeholders need first to be identified. Then the desirability of their involvement and the means by which they may become involved may be considered.

CASE STUDY 2

Potential spin off: City and Docklands Gardening Company

City and Docklands Gardening Company (CDGC) is a horticultural business that was set up in early 1998 for the purpose of providing quality customer focussed maintenance and landscaping of communal gardens. It is a social firm and a commercially viable business. 70 to 80% of its income is derived from commercial activities; the rest from various grants and charitable funds.

CDGC emerged initially as an employment project of a voluntary organisation called Working Support that helped people with learning difficulties to find jobs. It remained part of Working Support until two years ago when it transferred to the ownership of

the Shaw Trust, a national charity catering for the needs of people with disabilities. CDGC now operates as part of Shaw Trust Ltd, Shaw Trust's trading company, (a company limited by guarantee).

Currently, a major area of concern for CDGC is governance and the possibility of setting up a stakeholder management committee. The committee is considering the idea of spreading ownership or at least management throughout the staff team. One of the possibilities is to establish CDGC as an independent organisation, maintaining close links with the charity and its trading arm.

1.3.1 Identifying stakeholders:

Stakeholders may be:

- Employees
- Customers/service users and their families
- The local community
- Local voluntary organisations
- The local authority
- Grant makers/donors

1.3.2 Advantages of stakeholder involvement:

- Giving stakeholders a sense of ownership can encourage them to support the enterprise. This may take the form of increased employee productivity or customer/service user loyalty.
- Engagement can help with raising finance from stakeholders.
- Services can be better tailored to user/customers needs, when there is a greater opportunity for direct input and/or feedback.

1.3.3 Disadvantages of stakeholder involvement:

- Slower decision making because a wider group of people need to be consulted.
- Directors that hold their position because they represent a major stakeholder may not have the same commitment to the social enterprise itself.
- Stakeholder apathy – involvement can be a burden if not coupled with genuine commitment.

1.3.4 How to involve stakeholders?

Ways of involving stakeholders include:

- **Formal constitutional membership**
This involves stakeholders having a constitutional function arising from a right to attend and vote at annual and special members' meetings. At such meetings, typically, the management committee will be elected, accounts will be presented and the

management committee will otherwise be held to account. There can be different classes of members with differing rights, if appropriate.

- **Associate membership**

This involves a membership scheme, for example, for users or interested parties to receive information and/or offer informal opinion without formal constitutional voting rights.

- **Direct rights of nomination or appointment or to be consulted**

Such rights often belong to constitutional members of an organisation, but it is possible for other organisations or interest groups to have direct powers of nomination or appointment. Nomination means proposing an appointee to be ratified by those with the power to appoint. Formal rights to be consulted in relation to appointments can also be provided.

- **'Ex officio'**

This is where there is provision for an automatic appointment to the management committee because the individual holds another office. For example, with a voluntary organisation spin-off the constitution of the social enterprise might specify that the chairperson of the board of trustees of the charity will be an ex-officio management committee member.

- **Advisory Groups**

Provision can be made for an advisory group. This may consist of people, sitting either in their own right, as representatives of stakeholders, or as experts in a particular field. Their advice will be provided to assist, but not to bind the management committee.

- **Committees**

It is possible for the management committee to delegate consideration of issues and administrative decisions to committees on which stakeholders may sit or be represented. The members of the sub-committee need not be directors or members of the management

CASE STUDY 3**Stakeholder involvement: Coin Street Community Builders**

Coin Street Community Builders (CSCB) is a not-for-profit development trust which has responsibility for regenerating 13 acres of prime real estate on London's South Bank. By the time of the incorporation of CSCB as a company limited by guarantee in 1984 there was already a pool of active supporters, who had gained expertise both from participation in the planning debate for the site and from developing and running earlier housing co-ops in the area.

CSCB has chosen, however, not to use the possibilities inherent in the structure of a company limited by guarantee to build up a wider membership base of individuals supporting the initiative. CSCB makes no distinction between membership of the company and membership of the board itself – the directors and the members comprise the same group. Importantly, however, CSCB's rules do state that all members must be local residents, and its

board is therefore drawn from the immediate neighbourhood. (The board has chosen to co-opt a small number of other people, with particular legal, financial and marketing expertise).

CSCB engages and is accountable to its stakeholders in a number of distinct ways. There are formal and legal channels of accountability, including those to bodies such as the Housing Corporation, local authorities, and the commercial funders who have invested in CSCB and its projects. There are also formal relationships with each of the four housing co-operatives, to which CSCB leases the residential properties it builds. In the case of the wider community, CSCB points to its record of setting up independent mechanisms (such as the South Bank Forum for local residents, and the South Bank Employers' Group) to help build a shared community vision and to provide a means of implementing it.

committee (subject to contrary constitutional provision).

- **Feedback**

Stakeholders not included in the formal structure of the organisation may still be involved in policy decisions, through informal consultation procedures, including meetings, surveys and questionnaires.

1.4. Social ownership

One of the main purposes of a legal form is to clarify and structure the organisation's 'ownership'. 'Owners' have the right to run the organisation and to make the most important strategic and financial decisions and usually benefit from the enterprise's results or profits.

In a private sector enterprise, the owners are generally those who have invested their money in the company or enterprise. Accordingly, the legal forms most commonly used by regular businesses provide the decision-making powers and financial benefits to the investors or shareholders.

A defining feature of all social enterprises is that their idea of ownership is not based on investment for financial return, but on the idea of a group of people sharing a common bond or common aim – the pursuit of the social objective. The group of people sharing the common aim or bond are the social enterprise's 'community'. Consequently, in a social enterprise ownership belongs to the community. This way of understanding ownership is referred to as 'social ownership' and constitutes one of the main characteristics of a social enterprise.

The fact that social enterprises do not perceive ownership in the same way as the majority of businesses has a substantial impact both on their choice of legal structures and on the way they raise finance, as we will see throughout this booklet.

The choice of legal structure in a social enterprise will generally be very closely related to who the social enterprise considers to be its 'community' and to how the social entrepreneurs want to articulate the participation of and benefits to that community. So the choice of legal structure implies a particular vision of social ownership. The most common models are the following:

- The **service model** – where control rests with a small management committee or board without beneficiary-members. The business is run to provide services for others, who are considered to be the 'community' (as defined above). Any investments made by board members or other stakeholders under this model tend to be nominal and any profits are reinvested in the social enterprise. Organisations using this model include many social businesses, intermediate labour market companies, some social firms, service providing charities, the trading arms of charities and some development trusts.
- The **single stakeholder model** – where there is a large group of members drawn from the beneficiaries, who usually constitute the 'community'. The emphasis is on self-help. In employee-owned firms, any employee is eligible to be a member. In community businesses, residents in the community are eligible to become members. In consumer co-operatives and credit unions everyone who is a client of the business may apply for membership. Under this model of social ownership, members often invest more than a nominal amount and sometimes their constitutions allow for a distribution of profits to the membership or community within certain limits.
- The **multi-stakeholder model** – where there is joint-ownership by two or more stakeholder groups. A development trust may be a

partnership between community members, members of the business community, and voluntary or community groups. Social firms may include both representatives of sponsoring agencies and representatives of the beneficiaries. Some producer co-operatives include both the farmers and the employees in the membership. The community here is defined by a combination of stakeholders with different interests in the social enterprise.

1.5 Group or integrated structures

Sometimes it is desirable to set up more than one legal entity to run a social enterprise. The driving factors for this are usually tax efficiency or ring-fencing risk. Examples of this include:

- A charity and its **wholly owned trading subsidiary**.
- A social enterprise or business may set up an **associated charity** to run the parts of its operation that are charitable. Here the charity will not wholly own the social enterprise, structurally it is the other way round. (Although charity law dictates that, while the social enterprise may be involved in relation to the charity's management, the charity's trustees must maintain an independent discretion). The social enterprise, could be the sole member of the charity, or have power to appoint some or all of the trustees. The advantage of this is that the charity can take advantage of the considerable tax benefits available only to charities (see Chapter 5).
- Any social enterprise may have one or more **subsidiary companies** to ring-fence particular risks. For example, one company may own property and lease it to a related operating company that deals with the service provision which is run from the building.
- **Federations**, with one umbrella organisation and a number of local organisations. Each local organisation may have the umbrella organisation as its sole member, or the membership might be wider, with the umbrella

organisation having power to direct significant aspects of the local organisation. Alternatively the local organisation may be constitutionally independent of the umbrella organisation, but

controlled instead through a contract that franchises the business model and/or licences use of the brand name and logo.

CASE STUDY 4

Group structures: Coin Street Community Builders

As discussed in the last case study, Coin Street Community Builders (CSBC) is a company limited by guarantee. In terms of structure, however, CSCB is only one element in the broader Coin Street picture. Since CSCB is ineligible for charitable status, four registered charities have also been established to undertake those activities which meet charitable objectives as housing co-operatives. This enables the charities to fundraise autonomously from CSCB and it also allows CSCB to benefit from Gift Aid relief (see chapter 5, point 5.6.1) when it makes contributions to their work.

Also closely linked in practice with CSCB, although legally an autonomous

organisation, is Coin Street Secondary Housing Co-operative (CSS), a housing association which is registered with the Housing Corporation as a social landlord. CSS was established in 1987, a necessary step to access Housing Corporation finance. CSS undertakes the housing developments and then grants short-term leases to the four charities.

Finally, CSCB has created a wholly owned subsidiary, South Bank Management Services Ltd, which manages the Oxo Tower, Gabriel's Wharf, the public park (Bernie Spain Gardens) and the river frontage. This includes collecting rents and service charges, gardening and marketing services.

2 Incorporation

2.1 What it means to be unincorporated

2.1.1 Being unincorporated means that the business has no separate legal identity of its own. The risks and liabilities involved in running the business belong to the individuals who own and/or manage it. Unincorporated businesses include:

- **Sole traders**
Sole traders are individuals who set up on their own and are solely responsible for their business, for example a self-employed plumber or taxi driver. There is no requirement for a constitution or registration. Sole traders may employ staff and trade under a business name.
- **Partnership**
A partnership is 'the relationship which subsists between persons carrying on a business in common with a view to profit'. If, for example, two window cleaners decided to buy a van together and pool their resources then they would be creating a partnership. There may be a partnership agreement regulating its affairs. If not, (or to the extent

matters are not covered by such an agreement) the provisions of the Partnership Act apply. There are no registration formalities. Partnerships are often called 'firms'.

- **Unincorporated association**
Unincorporated associations tend to be larger groups of people that come together for a particular purpose, for example running a sports club. They usually have a constitution that sets out the rules that govern their relationship and a broad membership which elects a management committee to run the organisation on behalf of the members. An unincorporated association is a more likely vehicle for a social enterprise than a sole trader's business or a partnership.

2.1.2 The central feature of an unincorporated business is personal liability for the sole trader, partner or member of the management committee. Those individuals enter into contracts including leases and employment contracts and other obligations on behalf of their organisation and they are responsible for its debts and other

CASE STUDY 5 Unincorporated association: Core Arts

Core Arts was established as an unincorporated association in January 1992. Its creation was initially an unintended and haphazard response to artist Paul Monks' arrangement with the Hackney psychiatric hospital to use an empty room free-of-charge as an arts studio. His studio became a haven for artistic expression, as curious patients, seeking refuge from the monotony of life on the psychiatric ward, immersed themselves in a world of paint

and colour. After a couple of years, a regular group of patients had formed.

The group continued to operate as an unincorporated association until 1994 when it reconstituted as Core Arts Ltd, a company limited by guarantee, with the association members becoming company members. The change was prompted by growth including the employment of staff.

liabilities. This means their personal assets are at risk if the assets of the business are not sufficient to cover all the debts and liabilities.

2.2 Why incorporate?

2.2.1 Legal personality

An incorporated business is itself a legal entity in its own right. This means that the company itself enters into contracts, employs staff, leases property and has obligations and liabilities.

2.2.2 Limitation of risk

Incorporation as a company or industrial and provident society (society) limits personal liability, (although it does not remove it altogether). There is, however, a comfort in the debts and obligations of most incorporated organisations being the responsibility of the corporate organisation and not its individual management committee members, shareholders or members. Incorporation is an important consideration if the social enterprise intends to employ more than a few staff, take on significant property interests or undertake major contractual obligations.

2.2.3 Clear ownership structure / governance

Unincorporated organisations can operate relatively informally; being governed only by their constitutions, though this means powers and processes for decision making can be unclear. Incorporation involves the formalisation of governance structures within a legislative framework.

2.2.4 Developing a sense of ownership

Incorporation provides an established formal structure for stakeholder membership.

2.2.5 Accountability and disclosure giving public confidence

With limited liability come regulation and disclosure requirements. Limited companies have to have a registered address, file their constitutions, annual accounts and prescribed details of their directors etc.

2.2.6 Recognition by financial institutions and investors

Many banks and financial institutions will insist on incorporation before providing loan finance. The company limited by shares, in particular, is well understood as an accountable vehicle of capitalism.

2.2.7 Availability of equity finance (see chapter 5).

2.3 Why not incorporate?

2.3.1 Light touch regulation

Being unregulated allows greater freedom of operation, (within the general law).

Companies are regulated by Companies House and industrial and provident societies by the Financial Services Authority. Corporate organisations have to register, complete annual returns and file accounts etc. Failure to meet such obligations is an offence.

An unincorporated organisation is required to:

- Register for VAT if its annual turnover subject to VAT is estimated to exceed £55,000 (2002 figure).
- Operate the pay-as-you-earn scheme (PAYE) for its employees.
- File accounts with the Inland Revenue.

Note: Charities (which can be corporate or unincorporated) are subject to specific charity law regulation in addition to the general law (See Chapter 4).

2.3.2 Tax advantages

- Sole traders and partners pay their tax in arrears in January and July rather than up front via PAYE. This can help cash flow. (PAYE will apply to their employees).
- Reduced rate NI contributions are applicable to owners who are treated as self-employed.
- Sole trader/partnership losses may be set against tax paid in previous years.

2.3.3 Stage of development linked to risk

If your business is still small and is run by a small group of people who also own it, the disadvantages of regulation and compliance may outweigh the flexibility and freedoms that unincorporated organisations enjoy and the benefit of limited liability.

2.4 How to incorporate

There are four corporate vehicles commonly used by social enterprises:

- Company limited by guarantee (CLG).
- Company limited by shares (CLS).
- Industrial and Provident Society – Society for the Benefit of the Community (also known as Community Benefit Society or Bencom).
- Industrial and Provident Society – Bona Fide Co-Operative (Co-operative).

These are described in more detail in Chapters 3 and 4.

Summary of triggers which may indicate it is time to incorporate:

- Taking on a lease
- Buying a freehold property
- Taking on employees
- Raising finance
- Entering into large contracts
- Risk management related to your product or service.

3 Using a Company

3.1 Introduction

The two types of limited liability companies available for use by social enterprises are: the company limited by shares (CLS) and the company limited by guarantee (CLG). The CLG is a structure for non-profit distribution, thus many are also charities or trade associations.

CLSs are divided into private companies (which make up the great majority) and public limited companies (plcs) which can offer their shares to the general public. Many (but not all) plcs are quoted on the stock market so that their shares can be easily bought and sold.

3.2 Key features of social enterprise companies

3.2.1 All limited liability companies have an 'objects' clause. This sets out the company's aims or purposes e.g., to operate the business of recycling furniture. It is possible to state that the object of the company is to carry on business as a 'general commercial company' in which case it may carry on any trade or business and do all such things as are incidental or conducive to carrying on any such trade or business. For a social enterprise, however, a more particular definition of the objects may well be desirable. For a charitable social enterprise the objects must be exclusively charitable (see Chapter 5).

3.2.2 The social or public interest which the social enterprise company aims to meet is usually underpinned by a constitutional requirement that the profits of the company are (unlike those of a commercial company) not to be paid out to the members by way of dividends, but instead have to be retained for application towards the company's social or public purpose.

For charitable social enterprises this is essential and invariable. For other social enterprises consideration could be given to extending the non-profit distribution provision by specific constitutional drafting, for example, to provide comfort to prospective funders.

There may also be provision (as required for all charitable companies) that in the event of dissolution of the company any surplus will not be divided among the members but will go to a social or public purpose. In certain circumstances, such a 'non-profit distribution clause' will allow specific communities or categories of members who need support to benefit from an ultimate distribution of surplus. In some cases some profits may be distributed. However, in all cases the crucial feature of a social enterprise is that it is primarily seeking to achieve a social purpose – even if some profits get distributed in contrast to the primary aim of a commercial company which is to enhance the value of the company for the benefit of its shareholders.

3.2.3 Companies are legal entities, so that individual directors and shareholders are not exposed to personal liability (except in exceptional limited circumstances).

3.2.4 A company's constitution is contained in two documents:

- **The Memorandum of Association** which contains the objects and powers, and may contain a non profit distribution clause in the case of a social enterprise, the amount of the share capital in a CLS, or of the members' guarantee in a CLG.
- **The Articles of Association** which sets out the internal management structure and procedures i.e. the roles of members and directors and procedures for their appointment and removal and for the conduct of meetings, etc.

3.3 Power structures

3.3.1 All companies have a two-tier power structure. In a CLS (subject to contrary provision) the shareholders have the powers to:

- Elect and dismiss the board of directors.
- Appoint or dismiss the auditors.
- Change the Memorandum and Articles of Association by special resolution (i.e. a resolution passed by 75% of the shareholders present and voting at a meeting of which at least 21 clear days notice has been given).
- Approve the payment of dividends.

3.3.2 In a CLG, the members have the same powers as the shareholders of a CLS except that the CLG cannot declare a dividend because it has no share capital.

3.3.3 The managerial tier in the power structure, in both the CLS and the CLG, is the board of directors. The directors are typically appointed by the shareholders/members. Typically, again, some of them will retire each year at the annual general meeting, thus submitting themselves to re-election. A maximum continuous period in office may be prescribed.

3.3.4 In some cases the members/shareholders and the directors are the same people and the board may, in practical terms, operate without the formal check of accountability provided by the second tier.

3.4 Officers

3.4.1 Every company will designate one of the directors as a chairperson (even if only meeting by meeting) and have a company secretary. The chairperson is normally elected by the board of directors. He or she serves as the first among equals and may have a casting vote in the event of deadlock. The company secretary is usually responsible to the board for basic company law compliance, such as maintaining the company's

statutory books and attending to routine filing obligations. It is usual for the board to delegate management functions to a managing director (who is usually not subject to retirement by rotation) or the senior employee below board level ('the Chief Executive'). It is usual to have another director who is specially responsible for the company's financial affairs.

3.5 Duties and liabilities of directors

3.5.1 The directors of a company have a duty to act in its interests and to exercise reasonable care in their management functions. However, a director is entitled to rely on fellow directors in the absence of grounds for suspicion. These duties are owed to the company and directors are not normally exposed to third party claims. However, this can arise, for example, in an instance of wrongful trading. It is possible to take out directors and officers' liability insurance to cover such potential liabilities in the absence of fraud, or other bad faith.

3.5.2 In the case of a public company or a private company which is a subsidiary of a public company, the age limit for serving as a director is 70.

3.6 Board structures

3.6.1 Board structures may be constructed to suit the particular company, but generally divide into three types:

- **Oligarchy** – where the shareholders/members are the same people as the directors and new appointments are therefore made by the board. To preserve the structure it should be clear that when someone ceases to be a director, they also cease to be a member (in a CLG) or that they must offer their shares to the remaining shareholders in accordance with a prescribed procedure (in a CLS).
- **Representative Oligarchy** – where members or shareholders are not individuals but organisations, e.g., a local authority; a charity

etc. Each member/shareholder then appoints an individual to serve as director. The directors serve as long as the organisation appointing them wishes. It is possible to build in safeguards requiring the member organisations to review their appointment every three years, to put a time limit on the period of office of directors and to require the member organisation to replace its director if the majority of the other directors request it to do so.

- **Elected by Membership** – where there is a true distinction between the member/shareholders and the directors. The membership/shareholder group is wider than the directors and they elect the board. It is possible to provide for different stakeholder groups/members to elect directors to represent their interests e.g. a group of local authorities can elect one director etc.

3.7 Incorporation

3.7.1 Incorporating a CLS or a CLG is very simple. There are often standard forms of Memorandum and Articles of Association that can be used. Once you have agreed your constitution, an application to incorporate is submitted and is processed by Companies House within seven days. The incorporation fee is £20. A same day incorporation costs £80.

3.8 Regulation

3.8.1 The best things in life may be free, but limited liability is not one of them. The price payable for limited liability is public disclosure. In contrast the internal affairs of a sole trader's business, partnership or unincorporated association may be kept secret. The key disclosures are:

- An annual return which has to be forwarded to the Registrar within 42 days of the annual general meeting plus a £15 fee.

- Audited accounts which have to be filed with the Registrar within 10 months of the end of its financial year. If a company's turnover is less than a £1 million per annum (or £250,000 for a charitable company), it does not have to produce audited accounts. However, it may be desirable to have them audited anyway to give assurance to external supporters, financiers etc.
- Details of changes of directors and the company secretary constitutional amendments and other disclosable matters have to be filed within 14 days.

3.9 Financing

3.9.1 A limited company can mortgage its assets to a lender in a wider and more flexible way than an unincorporated association, partnership or sole trader can (with strict disclosure obligations).

3.9.2 A mortgage by a company (usually called a charge) over land, vehicles and other property has to be registered at Companies House within 21 days of its creation. Only a mortgage by an unincorporated business over property has to be registered which means it is easier for lenders to check up on how much security a limited company has given, compared with an unincorporated business.

3.9.3 Unlike unincorporated businesses, limited liability companies can give a 'floating charge' which applies to assets which keep on changing or fluctuating e.g., stock or debtors. The floating charge hangs like a net above the assets charged. At the moment the charge is triggered ('crystallises' in legal jargon), the net drops and covers all the charged assets at that moment. So, for example, all the stock which is owned by the company (and not subject to a prior charge) at the moment the floating charge is triggered becomes security for the debt due to the lender and secured by the floating charge. The floating charge is only triggered when certain conditions set out in the terms of the charge or loan facility under which the charge was given take effect.

3.9.4 Share capital – companies limited by shares

- Each company limited by shares divides its share capital into shares of fixed amounts. The usual share capital for a small limited company is £100. This is known as the company's authorised share capital.
- The authorised share capital is divided into shares or units. The shares can have a nominal, face or par value (which all mean the same) of any amount between 1p and £100 (or even higher) but it is normal to give the shares a nominal value of £1. Hence, it will be normal in the case of a limited company with an authorised share capital of £100 for its capital to be divided into 100 shares with a nominal value of £1 each. If 50 of the shares were issued, the limited company would have an authorised share capital of £100, an issued share capital of £50 and un-issued share capital of £50.

- Shares are also known as equity or risk capital. Ordinary shares usually carry the main financial risk if the limited company is unsuccessful because, if a company goes into liquidation, the ordinary shareholders are the last people to get their money back. Shares also carry the greatest prospect of financial reward if the company is successful. The ordinary shareholders are rewarded by dividends paid when distributable profits are available.

3.9.5 Preference shares

Preference shares carry preferential rights over ordinary shares, but carry less potential for reward. Their principal features are:

- **Type of dividend** – preference shares are usually described as, for example, 4% preference shares. This means that for each £1 invested a dividend of 4% per annum is paid. Hence, the dividend is fixed, rather like an interest rate. However, unlike a loan the

CASE STUDY 6

Company Limited by Shares: Aspire Group

Aspire is a social enterprise selling fair trade catalogues that creates full time employment for homeless and other socially excluded people. Aspire employees deliver the catalogues to over 1 million UK homes and they are paid between £150-£170 per week. In 2002 the organisation had a turnover of over £1,000,000 and employed 150 homeless people in the UK and as many fair-trade producer groups overseas. Since its birth in Bristol in May 1999, Aspire has shown a strong entrepreneurial ethos and has strived to become a self-sustainable commercial business. Currently, Aspire has major expansion plans that include the establishment of new 'branches' in several major UK cities, as well as the potential development of new business units such as market stalls, cafes and shops.

Aspire was initially incorporated as a company limited by shares both to emphasise the company's identity as a commercial business and to enable the business to raise the necessary funds to finance its ambitious expansion plans. Whereas their legal structure allowed them to raise the necessary capital through a venture capitalist and other commercial investors, it also inhibited borrowing from some community development financial institutions (CDFIs) and financing from the charitable sector.

In order to overcome these limitations, Aspire has now set up a charity as an overall umbrella that owns 100% of the company's shares. Investment in the catalogue company remains as subordinated loan stock as well as redeemable and non-redeemable preference shares.

dividend on preference shares can only be paid if profits are available for distribution.

- **Cumulative preference shares** – In this case if dividends are not paid in one year, the arrears of dividend accumulate and may be paid in later years.
- **Redeemable preference shares** – These shares are issued for a fixed period e.g., ten years, and at the end of the ten year period, the company redeems them by paying back the initial capital.
- **Convertible redeemable preference shares** – In this case the shareholder can call upon the company to convert the preference shares into ordinary shares. Hence, an investor having received fixed rate dividends during the high risk early years in preference shares, can switch to high yield ordinary shares. The rate of conversion is normally the result of negotiation and is set out in the Articles of Association.

3.9.6 Dividends

Dividends on preference shares are paid before the dividends on ordinary shares. Dividends can only be paid if there are profits available for distribution. If the company has accumulated losses on its balance sheet, it has to accumulate sufficient profits to expunge the losses before making a distribution.

3.10 Disqualification

A person may be disqualified from being a director of a company by court order. This will be given where a director has:

- Been ruled to be unfit to be concerned in the management of a company.
- Been convicted of certain criminal offences.

3.11 Changing the Memorandum and Articles of Association

Most clauses contained in the Memorandum and all the Articles of Association can be changed by special resolution (one passed by a 75% majority in a members' meeting).

3.12 Group structure

A CLS or CLG can become the sole member or shareholder in another CLG or CLS which is established as its subsidiary.

3.13 Companies limited by guarantee

3.13.1 In a CLG there are no shareholders. The members give a 'guarantee' to cover a company's liability. However, the guarantee is nominal, normally being limited to £1. A CLG offers the possibilities of a democratic one member, one vote system. The members normally only meet once a year at the annual general meeting when they exercise the powers outlined in paragraph 3.3.1. Most CLGs contain a non-profit distribution clause and therefore the members do not have a right to a share in dividends or any surplus on the winding up of a company. It is possible to give members greater powers so that they are consulted by the directors on more issues and the distinction between the directors and the members can be reduced. However, one has to be careful in doing this to ensure that one does not give so many powers to the members that they become, in fact, directors and liable as such.

3.13.2 It is possible to create different categories of membership if desired, such as local authority members representing local authorities, user members representing users etc.

3.14 Brand recognition

3.14.1 The CLG brand has been traditionally associated with charities, trade associations and not-for-profits. With the creation of Network Rail, CLGs have been given rather more publicity recently and they are increasingly used in the not-for-profit world as a more flexible and easier to establish model than the industrial and provident society.

3.14.2 The CLS is recognised as being the motor of capitalism. Not many social enterprises are established as CLS and there are very few charitable CLS.

3.15 Employee share schemes

There are ways of using shares to involve employees in the ownership of a business and there are certain tax concessions to facilitate this. However, there is also a risk for employees, if they are asked to invest in their employer only to find that if the business becomes insolvent they have lost their savings as well as their job. The John Lewis Partnership is a good example of a CLS in which shares are held by staff.

4 Industrial and Provident Societies (societies)

4.1 Introduction

Societies are incorporated legal forms. There are two types of society capable of registration under the Industrial and Provident Societies Act 1965 (IPSA):

- Society for the Benefit of the Community (commonly known as a Community Benefit Society) – set up to trade for the benefit of the community rather than its individual members.
- Bona Fide Co-operative (commonly known as a Co-operative Society or Co-operative) – traditionally set up to conduct business through member participation for mutual benefit.

In the year 2000 there were approximately 9,360 societies¹. As with companies, not all societies are social enterprises.

4.2 Key features of societies

4.2.1 Purpose

A society can only be registered under IPSA if the registering body (the Financial Services Authority or FSA) is satisfied that it fulfils one of two purposes set out in the Act. These are as follows:

- **Community Benefit Society**

A community benefit society must be established for the 'benefit of the community', and must have some special reason for seeking registration as a society and not as a company. In practice this means that it must demonstrate that benefits will not be returned to its own members and that its business will be conducted for the benefit of the community.

- **Co-operative Society (Co-operative)**

An organisation may be registered as a co-operative if its rules reflect the principles given in the 'International Co-operative Alliance – Statement on the Co-operative Identity'. This statement describes a co-operative as 'an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise'.

4.2.2 Societies share many features with companies, including the following.

- a) Limited liability (the liability of members is limited to the amount of any unpaid share capital).
- b) A registered written constitution, set out in rules (rather than a memorandum and articles of association).
- c) Members who hold a share or shares.
- d) Directors to whom the power to manage the business is usually delegated in the rules (but see further below).

4.2.3 Societies have some significant differences from companies, of which the main ones are as follows.

- a) Role of FSA – unlike the role of the Registrar of Companies in relation to companies, the FSA has a significant regulatory function in relation to registration. Only societies which meet the social criteria defined in the Act can be registered, and the FSA monitors continuing compliance with these criteria by having to approve any constitutional change. The FSA has the power to suspend

¹ 'Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector', Cabinet Office Strategy Unit, 2002.

or ultimately to cancel registration if a society does not adhere to its registered purpose. This is a powerful mechanism for ensuring adherence to a society's original social purpose.

- b) Distribution – as already pointed out, no distribution to members is permitted in a community benefit society. In most co-operatives, distribution is permitted, but this is not based upon the sharing of profits, so much as returning the surplus to those who have traded with the society, in accordance with the amount of their trade. This goes back to the origins of co-operation based on principles of enabling people to have access to basic provisions, without exploitation (at a fair price).
- c) On a winding up, members of a community benefit society, and in many cases the members of a co-operative society only have a right to the return of their capital. They do not have a right to a share of the underlying assets (or equity), and the rules normally make alternative provisions for the application of any surplus on a solvent winding up.
- d) Share capital – No individual is permitted to own more than £20,000 of capital in any society. In community benefit societies, the members commonly only hold a nominal amount of share capital. In co-operative societies, it is common for members to hold greater amounts, and unlike company share capital, it is usually withdrawable, occasionally transferable, subject to the rules.
- e) It is common in societies (mandatory in co-operative societies) for voting to be on a one member, one vote basis, whatever the shareholding. This contrasts with a company where the number of votes is normally based on share-holding.

CASE STUDY 7

A community benefit society: Early Years Centre Roundshaw

The Early Years Centre at Roundshaw is an example of a social enterprise incorporated as a community benefit society. It is a nursery that currently caters for 24 children, with five permanent members of staff and a turnover of £120,000. Their choice of legal structure was motivated by two reasons: Firstly, childcare is a labour intensive sector and there was a general agreement that the staff had played a major role in the start up and development of the nursery. There was therefore a consensus about offering staff the possibility of being represented in the management board.

Secondly, the nursery has identified opportunities for growth within the government funded Neighbourhood Nurseries Initiative. It expects to double its capacity in 2003. The expansion will require

substantial build work and hence, capital expenditure, which the nursery hopes to raise through public grants and charitable trusts. From that point of view, registering as a charity was a desirable option.

While employees of a charity cannot simultaneously be its trustees, community benefit societies can include members of staff among its directors in the management board while keeping a charitable status recognised by the Inland Revenue for tax purposes. Thus the community benefit society structure enables Early Years Centre at Roundshaw to have the benefit of charitable status while recognising its staff as key stakeholders of the social enterprise through offering them to the chance to participate in central decisions affecting the nursery.

- f) Whilst it is possible to register a completely new set of rules with the FSA, it is common to choose to adopt (in whole or in part) model rules registered by one of the sponsoring bodies. There are many different sets of model rules in a variety of sectors. Since societies are already subject to the regulation of the FSA, those wishing to benefit from charitable status do not have to register separately with the Charity Commission, but can operate as what are known as 'exempt charities' (see further in chapter 5). They thereby enjoy all the fiscal benefits of charitable status, but with a rather lighter regulatory regime.

4.3 Power structures

4.3.1 Co-operative societies are obliged to have voluntary and open membership, as it is one of the co-operative principles. Membership is commonly open to anyone who is more than 16 years old. Corporate organisations such as companies and other societies can also be members if their objects permit it. Unincorporated associations cannot be members unless they nominate a representative.

4.3.2 Community benefit societies do not have to have voluntary and open membership, though they may and frequently do choose to do so where they are seeking to achieve community ownership.

4.3.3 In a society the members normally have the following powers:

- To elect and dismiss the board of directors or management committee.
- To appoint and dismiss the auditors.
- To change the rules by special resolution.
- To approve a transfer of engagements, amalgamation or conversion (see 4.10.2).

4.3.4 As in a company, power is shared between the members in general meeting, and the board of directors or (as it is sometimes known) the management committee. The method of

appointment to the board or committee varies, but a board or committee member must be at least 18 years old.

4.3.5 It is common for the board or committee of a society to comprise (in whole or in part) lay people. This reflects the community background and origins of this legal form, and the fact that societies are often self-help organisations set up within communities to ensure the availability of particular goods or services. Where such organisations become substantial, their rules commonly permit or require the appointment of a chief executive, and other executive management.

4.3.6 The society form is flexible in its governance arrangements to accommodate the many different situations which arise with greater or lesser representation at board level of lay members (to preserve democratic accountability) and professional board members (in regulated or complex businesses). It is a combination of this flexibility and the historical origins of the legal form (the mutual or self-help movement in the early nineteenth century) which make them attractive as potential vehicles for social enterprises, particularly when such enterprises are established to carry on business in a way that is markedly different from companies operating on the conventional profit-motive.

4.4 Officers

4.4.1 All societies have a board or committee, and a secretary. The secretary's role in a society is often substantial, particularly in co-ops and community benefit societies which are based on democratic principles. This contrasts with the company secretary's role which is usually a formality. As already mentioned, larger societies usually have a chief executive and possibly other officers.

4.5 Duties and liabilities of the board of directors or management committee

Directors of a society owe fiduciary duties and duties of skill and care which are similar to those owed by directors of companies. The key differences are as follows. Fiduciary duties – whilst directors of a society owe a duty at all times to act in the best interests of the society, this is in the context of fulfilling its purpose (as a community benefit society or co-op). Decision-making may therefore be somewhat different from the same process in a company based on a purpose of delivering shareholder value.

Duties of skill and care – this is to be construed in the context of the constitution, e.g. where there is a lay board, and professional executive management.

4.6 Registration

The registration fee is dependent on the rules to be adopted by the new society. The fee is £100 for a society with model rules laid down by a sponsoring body, this fee increases with each amendment to the model rules. An entirely new set of rules costs £950 to register.

4.7 Regulation

As already stated, the FSA is responsible for regulation. Contact details are given in Annex 2. The key disclosures to be made are:

- Each society must send an annual return (containing revenue accounts and a balance sheet) to the Registrar within seven months of the end of the period covered by the return. If the society is required to have its accounts audited (see below) the annual return must also be accompanied by the auditors' report. The annual return also gives details of the society's officers.

- In general a society with a turnover of £350,000 or less (£250,000 or less if they are charities) can opt out of a full audit of their accounts, and those with a turnover of less than £90,000 and a balance sheet total of less than £1.9m can opt out of any audit.

4.8 Financing

Like the limited company, a society can mortgage its assets to a lender by granting charges over its assets. A society is permitted to give a floating charge (see paragraph 3.9.3). The charge must be registered with the FSA within 21 days of the date of the document.

The insolvency regime governing societies is different from that applying to companies in a number of respects. For example administrative receiverships and administration introduced by the 1986 Insolvency Act did not apply. However the position has been changed further by the Enterprise Act, which specifically permits insolvency law applying to companies to be applied to societies.

Loan Capital

- The power of a society to borrow depends upon the terms of its rules (as with a company). The rules are required to state whether or not the society has power to borrow or take money on deposit and if so on what conditions, with what security and up to what maximum level.
- The maximum borrowing limit must appear in the rules of a society but the Act does not give any indication of what that limit should be (as with a company).

Security for loans and registration of charges

- Societies can give security for loans if their rules permit this.
- Charges are registrable with the FSA.

4.9 Share Capital

Financing

- No member is permitted to have a shareholding in excess of £20,000 (although the rules may set a lower maximum limit).
- This maximum limit does not apply to:
 - Members who are also registered societies. (NB this does not include other corporate bodies such as companies).
 - Local authorities who have acquired a holding by virtue of the Housing Associations Act 1985.
 - Any member who acquired a holding under the Agricultural Credit Act 1923.
- The rules may lay down a minimum level of shareholding required as a condition of membership.
- Different classes of shares are permissible. It is unusual to have different classes of share within a single society, though it is not uncommon to recognise more than one class of members (eg consumers and employees).
- It is not permissible to have different classes of voting attached to different classes of shares as this contravenes the principle of one person, one vote. It is also not possible to pay a dividend by reference to the size of shareholding.
- The main advantage of a society is that there are no restrictions on the society buying-back or reducing share capital if it is issued in the form of withdrawable shares. The rules of the society must state whether its shares are withdrawable and if so how this may be done and how any balance is paid to members. The rules may provide for notice to be given or for a limit on the proportion of the share capital of the right to withdraw. A society with withdrawable shares cannot engage in banking.
- Transferable shares are also permissible.

- Forfeiture and cancellation of shares – the Act makes no reference to this and therefore the rules commonly provide for this.

4.10 Other issues

4.10.1 Brand Recognition

As with other social enterprises, there is no consistent branding of societies, though within registered societies are some high profile well-known groupings, such as the retail co-operative societies (which account for some £10 billion of trade). However, there are far fewer societies than companies, due to many factors including the failure to update and modernise Industrial and Provident Society law. This is now being addressed, with the enactment of the Industrial and Provident Societies Act 2002, and the possibility of further legislation this year (the Co-operative and Community Benefit Societies Bill which has government and cross-party support).

There is a revival of interest in the opportunities presented by industrial and provident societies, following the development of modernised constitutions particularly for community benefit societies. This is seeing the registration of new organisations in a variety of sectors including housing, childcare, and supporters trusts.

4.10.2 Change mechanisms/entrenchment

A further distinction from companies is the ability of societies to merge by a transfer of engagements. Under this statutory process, by resolutions of its members a society can transfer all of its assets and liabilities to another society. This simple and effective mechanism has been used extensively by societies, and is a very cheap and convenient process for corporate change.

It is also possible for two societies to amalgamate and both transfer engagements to a new society; for a society to transfer engagements to a company; and for a society to convert into a company. All of these processes are governed by statutory provisions.

The Act does not lay down any procedure for amendments to the rules although the rules themselves may make such provision. The relevant case law appears to conclude that a society may make such amendments to the rules which could be considered to be in the contemplation of the parties who originally established the society. It is arguable that this would prevent a Community Benefit Society from converting to a Co-operative Society.

It is possible to entrench certain provisions in the rules of a society, in order to make constitutional change, or change in certain areas, more difficult. This can be done either by requiring a higher majority to change particular rules, or requiring an increased quorum at any meeting considering particular changes.

It is also possible to provide in the rules that certain changes cannot be made without the approval of a public or statutory body (eg a local authority, or a sector regulator).

The 2002 Act introduces similar protection against demutualising societies to that already applying to building societies, namely by providing that any transfer of engagements or conversion to a company can only proceed if, as well as being passed by a special resolution, a majority of members takes part in the vote.

Conversions of industrial and provident societies has been rare (compared with conversions of building societies), and the 2002 Act now makes it unlikely.

5 Charities and Social Enterprises

5.1 What is a charity?

Charities can be established in England, Wales, Scotland or Northern Ireland under four heads of charitable purposes:

- To relieve poverty
- To advance education
- To advance religion
- For other purposes beneficial to the community.

It is possible to establish a charity using a variety of legal forms including a trust, an unincorporated association, a company limited by shares, a company limited by guarantee, an industrial and provident society, a body established by Royal Charter and a statutory corporation. The most common legal forms are company limited by guarantee, unincorporated association, trust and an industrial and provident society.

5.2 Charities and social enterprises

Many social enterprises are also charities – a recent survey by Social Enterprise London found that 58% of social enterprises in London have charitable status.¹ On one hand, operating a social enterprise through a charity offers very obvious tax and rate relief advantages. On the other hand, the organisational constraints that come with charitable status may make charities inappropriate vehicles for operating a social enterprise – especially if the charity is registered with the Charity Commission.

5.3 Key features

The key features of a charitable social enterprise are:

5.3.1 A charitable social enterprise has to be established with exclusively charitable objects (see 5.1).

5.3.2 The trustees of a charity are the persons responsible for its administration and management. They can be called trustees, directors, committee members and other names too. The trustees are normally unpaid. It is possible to have one paid trustee but this is unusual.

5.3.3 A further crucial feature of a charity is that any profits or surpluses cannot be paid out to its members but have to be ploughed back into the charity and used to fulfil its charitable aims. Consequently all charities have a non profit distribution clause. Charities are public benefit organisations. They are established to benefit the public and this means they have to be careful about not giving disproportionate levels of private benefit to any particular group or person.

5.3.4 Finally, a key element in charity law is that once assets have been applied to a particular purpose they have to continue to be applied for that purpose.

5.4 Charity trustees

5.4.1 Because of the fundamental rule that trustees are unpaid it frequently occurs that the founder of a charity does not serve on the board of trustees. It is sometimes possible to make an exception for a key person but it is certainly not

¹ 'Beeline Mapping Exercise', Social Enterprise London, 2002.

possible to allow the employees in general to serve on the board. This is a fundamental point of principle and can cause considerable difficulties for social enterprises where the founder(s) and employees wish to be involved in the strategic direction and management of the business and do not wish to answer to a separate group of outside trustees. At worst this distinction between volunteer, unpaid trustees and paid, full time employees can cause considerable conflicts between two groups with different aspirations. The trustees may well be risk adverse and not understand sufficiently well the operation of the business to be prepared to countenance new innovation and enterprise, in contrast to the founders/staff who may display greater day-to-day insight.

5.4.2 The Charity Commission is concerned to ensure that charities do not become alienated from their beneficiaries. With appropriate safeguards, Commission consent and constitutional authority users may serve as a minority of trustees.

5.5 Regulation of charities

5.5.1 The great majority of charities in England and Wales are regulated by the Charity Commission. In Scotland and Northern Ireland they are regulated by the Inland Revenue.

5.5.2 In England and Wales there are also exempt charities. These are charities which are

CASE STUDY 8

A social enterprise and a charity: Circus Space

The Circus Space is a registered charity, a social enterprise and a centre of excellence in the circus arts. The social enterprise's social aim and charity's primary purpose are one and the same: Advancing education for the public benefit through the promotion of the arts with particular but not exclusive reference to the circus arts.

The Circus Space manages to make most of its £900,000 turnover through the development of a series of income earning activities that are included within the charity's main purpose. These are artistic programmes which include the UK's only degree level education in the circus arts; professional development opportunities for performers; classes for children and adults and a varied performance programme, including the annual Circus Space Festival. They also provide affordable workspace for related arts companies and opportunities for private and public sector organisations to use circus skills as a staff development tool.

Just about 16% of Circus Space's income is generated through public grants, plus a further 10%, which tends to be raised from donations from individuals, trusts and foundations and businesses. Their charitable status has not hindered their commercial growth as their trading activities contribute to their charitable objective. In addition, their charitable status has enabled them to benefit from an 80% discounted business rate, as well as to raise capital grants from a variety of funders to redevelop the building that they occupy, a former electricity generating station that had lain derelict for over 30 years.

The main problem Circus Space currently faces in relation to their legal structure is the lack of understanding in the general public, and among some funders and public authorities, regarding the possibility of being both a charity and a social enterprise. This has caused branding conflicts for the organisation.

exempted from having to register with the Charity Commission because they are subject to regulation by another governmental body. Hence universities are exempt charities as they are regulated by the Higher Education Funding Council.

5.5.3 For social enterprises there is one very important category of exempt charity: a charitable industrial and provident society (society). A social enterprise has to satisfy the Financial Services Authority that it has a valid reason for becoming a charitable society. If it can, then this can be a very attractive route as the social enterprise obtains the equivalent of charitable status in England and Wales without Charity Commission regulation. Instead its charitable status would be recognised by the Inland Revenue in applying the income/corporation tax benefits available to charities.

5.5.4 The Charity Commission is an increasingly active regulator, particularly compared with the Inland Revenue. This has an impact in two ways:

- On registration the Charity Commission operates a gateway policy whereby it seeks to establish whether, to its satisfaction, a proposed new charity is suitably well organised and committed and has sufficient resources to merit registration. The whole process can take at least three months. It can also be expensive because an applicant may well need professional advice in order to help it through the registration process.
- Once registered, the Charity Commission exercises considerable scrutiny over charities, particularly those turning over more than £250,000 per annum. Charities have to file annual reports, accounts and an annual return. If the charity's annual turnover is more than £250,000 the accounts have to be audited. This is £750,000 less than in the case of a limited company. Charities with a turnover of less than £250,000 have to have their accounts independently examined. The Charity Commission has increasingly demanding expectations as to how charities should be managed and puts considerable resources into seeking to ensure that charities

abide by these recommendations including operating a series of review visits to charities to check on governance and other issues. The charity's accounts are subject to considerable scrutiny on filing and questions may be raised about them.

5.6 Taxation of charities

5.6.1 The limitations imposed by charity law and regulation by the Charity Commission in England and Wales have to be weighed against the tax advantages accorded to charities. These are considerable. They are the reason that many social enterprises seek charitable status. The principle advantages are:

- Tax relief on profits:
The profits of any trade carried on by a charity are free of tax if the profits are applied solely to the purposes of the charity and the trade is exercised in the course of the carrying out of the primary purpose of the charity.
- Chargeable gains made by a charity (e.g. on disposal of a property) are tax free.
- Charities do not pay tax on bank interest.
- Charities do not pay stamp duty.
- Donations to charities are encouraged and attract tax relief – for example:
 - Legacies to charities are exempt from inheritance tax.
 - Gift to charities by companies and organisations which pay corporation tax are tax deductible as a charge on income.
 - Donations by individuals to charities attract Gift Aid relief. This means that, provided the individual is a UK taxpayer, the charity can recover from the Inland Revenue the amount of the basic rate tax that the donor has paid on the amount of the gift.

Example: Gift of £1,000. This is treated as having come out of taxed income and is therefore grossed up at 22% so that

the charity can recover £280 from the Inland Revenue ($£1,280 \times 22\% = £280$).

In addition, if the donor is a higher rate taxpayer he or she can get a higher rate of tax relief of 18% on the full £1,280. This reduces the cost to the donor from £1,000 to £768 net of higher rate tax relief. Hence a donation whereby the charity receives £1,280 costs the Inland Revenue £512 ($£1,280 \times 40\% = £512$) and the donor £768.

- Gifts to a charity of assets are free of capital gains tax and the charity can then sell them and realise the profit free of capital gains tax.

5.7 Rate relief for charities

Charities are entitled to a mandatory 80% relief from unified business rate in respect of any property which they occupy wholly or mainly for charitable purposes. The local authority has discretion to give a further 20% rate relief. In rating law, 'wholly or mainly' means a bit more than half.

5.8 Charities and trading companies

5.8.1 Charities can only undertake a trade in fulfilment of their primary purpose, i.e. what the charity is set up to do. Many charities wish to undertake further trading activities in order to raise money for the charity but which are not in fulfilment of the charity's primary purpose. If this is the case then the charity will have to set up a separate for-profit trading company owned by the charity. It is normal for such trading companies to be companies limited by shares although they can be companies limited by guarantee. This arrangement is approved by the Charity Commission and the Inland Revenue.

Charities can undertake a small amount of for profit, non primary purpose trade through the charity. If they fall within the following exemptions they do not need to set up a trading company (i.e. it complements it):

- If the trade is ancillary to their main purpose they can carry on trade to a maximum of £50,000, provided the turnover of that part of the trade is less than 10% of the turnover of the whole trade.
- If the trade is not ancillary the maximum permitted turnover of that trade is £50,000 or 25% of the charity's gross income, whichever is the lesser.

Example: Charity: gross income £150,000.
Maximum turnover of non primary purpose trade permitted is $150,000 \times 25\% = £37,500$

5.8.2 Before a charity can establish a trading company, it needs to satisfy itself that it has the appropriate investment powers in its constitution that allows it to do so. If it is an unincorporated charity then it will have such powers under the Trustee Act 2000. If it is a company limited by guarantee then it will almost certainly have such powers in its Memorandum of Association, but it should check.

5.8.3 Charities also establish trading companies to carry out primary purpose trades in order to isolate risk in a separate limited liability vehicle. In this case, the charity can support the trading company not just through conventional financing methods (see paragraph 5.8.7) but also through grants since the trading company is carrying out the charity's own purposes.

5.8.4 The trading company will normally be established as a company limited by shares with the charity as the sole shareholder. The amount of money that the charity invests in the shares will depend on a number of factors including the charity's assessment of the financing requirements of a subsidiary. The charity will need to resolve the precise relationship between the two entities and in particular, the structure of the trading company's board and management.

It is advisable to have some but not all of the trustees serving as directors of the trading company. It is sensible to have two or three trustees only serving on the board of directors of the trading company. The rest of the directors of the trading

CASE STUDY 9**A wholly owned subsidiary of a charity: Core Design**

Core Design is Core Arts' first spin-off business (See Case Study 5). It was registered incorporated in February 2002 as a company limited by shares, with all shares held by Core Arts. The company currently has two employees and it also uses several freelancers, who are members of Core Arts. All its profits are transferred to Core Arts for use to further its social objectives. It has been agreed that the decision on whether surpluses should be reinvested in Core Design, held as reserves, or declared as profits to be returned to Core Arts will be taken by a joint meeting of the directors of the two companies. It became essential for Core Design to register separately as a company, because:

- Its activities were outside the memorandum and articles of association charitable objects of

Core Arts (the aim being primarily profit generation)

- The primary activities were profit-generating, and therefore not charitable.
- The turnover is now exceeding the requirement for VAT registration, and it would not be appropriate or desirable to make all of Core Arts' activities subject to VAT

Core Design can be described as a trading arm of Core Arts, the charity, but it also might be classified as working in ways that are similar to a social firm or intermediate labour market operator, by training people who have been excluded from the mainstream labour market by reason of their mental health, and enabling them to enter the mainstream labour market.

company can be drawn from the management of that company plus perhaps a non executive director or two with particular relevant expertise. It is not necessary for the chief executive of the charity to serve as director of the trading company, although it may be wise depending on the circumstances. It should also be borne in mind that the trustees of the charity cannot be paid for serving as directors of the trading company. This is based on the fundamental provision of charity law that a trustee should not benefit from his or her trust.

5.8.5 Charities with trading companies may be encouraged to set up share ownership/bonus schemes for employees of that company but they should be wary about doing so. Comparisons between commercial groups and companies and charities can be misleading and often overlook the fundamental objective of a charity, namely to act for the public benefit. Many charities share some of their staff and premises with their trading

company. If staff are partly engaged on the trading company's business and know that they may improve their personal financial position by increasing the profits of the trading company, they may concentrate their efforts on boosting its activities to the possible detriment to the charity. Their loyalties may be divided and they may be pulled towards the trading company.

Moreover the trading company might need working capital to finance its activities. It may seek this from the charity. That capital may be vital to the company's success and hence the remuneration of employees. But who will write the report to the trustees requesting this financial assistance be provided? It could well be employees of the charity who also work for the trading company and who thus have a financial interest in the outcome of the application to the charity for working capital.

What is more, the lower rate of interest charged by the charity on a loan to the trading company, the higher the profits of the trading company might be, which may in turn result in an enhanced profit bonus or share valuation for staff members. Such a conflict could lead the writer of the report to err on the side of recommending a low rate of interest which could lead to a breach of the Charity Commission's guidelines on loans (see clause 5.8.7). It may be difficult for volunteer trustees to spot all these ramifications in a short meeting in which they are, understandably, relying on a report prepared by the staff.

5.8.6 Most trading companies are set up to have a long term relationship to generate unrestricted funds for the charity which it can apply for its charitable purposes. But in some cases, a charity finds that it no longer needs to have the trading company and wishes to hive it off. This can cause great problems around the name of the trading company which will almost invariably be bound up with the name of the charity. Much of the trading company's goodwill (and therefore value) is likely to be associated with the charity's brand.

If a charity sets up a trading company with a view to selling it off in the future, or decides, after a while, that the time has come to consider selling the trading company, then it needs to consider seriously the question of developing a parallel brand under which the trading company could start to trade. To begin with it would use both the charity's and the new brand and then as the new brand becomes better known, the charity brand can be given less exposure until the trading company only trades under the new brand. Then much of its value and goodwill will attach to the new brand and the company can be sold for a much higher value than if it was being sold off with the business stripped of the right to use the charity's brand.

5.8.7 In deciding to finance a trading company, the charity trustees have to comply with their duty of care. Under the Trustee Act 2000, a trustee of an unincorporated charity is subject to a standard duty of care which obliges him or her to exercise such care and skill as is reasonable in the

circumstances, having regard to any special knowledge or experience he or she has. In the case of incorporated charities, e.g., companies, the trustees are under a similar duty. In particular, trustees have to avoid investments of a hazardous or speculative nature.

Often investing in a charity's own trading company is likely to be a far riskier investment than putting the money into more conventional forms of investment. However, in assessing any proposal to invest in a trading company, trustees may well be able to take into account the fact that the trading company is achieving a mixture of financial and charitable objectives. It may well be that some of the trading company's activities do fulfil the charity's objects. If this is the case then the charity does not need to expect a financial return on that part of the trading company's activities which fulfil its charitable purposes. For example, if a trading company undertakes 60% pure commercial activities and 40% activities in fulfilment of the charity's own objects, the charity only needs to seek a reasonable financial return on 60% of its investment, provided that this split continues and is likely to do so in the foreseeable future. Obviously the trustees will have to keep the ratio between charitable and non-charitable activities in the trading company under review.

5.8.8 If trustees decide to invest then they should be provided with sufficiently detailed information to allow them to make a sound and proper decision. Such information may well include:

- Market research (unless it is a question of a charity hiving off to the trading company a business which it has already built up).
- A budget showing projected capital and ongoing expenditure and income.
- A cashflow forecast for at least two years.
- A business plan showing how it proposes to develop.
- An analysis of working capital requirements.

The trustees should consider this information carefully and in detail, mindful of the need to

comply with their various legal duties. The minutes of the meeting should record any resolution to invest in a trading company and should refer to the documents upon which the trustees have relied in reaching that decision.

5.8.9 The Charity Commission accepts that charities will finance trading companies by way of loans. From the charity's point of view a loan with security is less hazardous than investment in share capital because if the trading company goes into insolvent liquidation, the secured creditors are paid out before the unsecured creditors and the shareholders. The Charity Commission recommends that where a charity lends money to a trading company it should:

- Charge a proper rate of interest.
- Take security for the loan.
- Lay down terms for repayment of the loan.

Taking these in turn:

A proper rate of interest – The loan should not be interest free unless the trading company is fulfilling the charity's objects. It will be normal to charge a rate that is higher than the charity would get if it were to deposit the funds with its bank.

Security – The charity should take a fixed and floating charge over all the assets of the trading company to secure the loan. This is of course subject to the assumption that no charge has been given to any other party, e.g., a bank. Care needs to be taken in respect of floating charges over book debts.

Repayment of the loan – It is most sensible to either to make the loan repayable after a period of a year or on demand.

5.8.10 Before making a loan to a trading company, charity trustees also have to consider whether or not the loan constitutes '*qualifying expenditure*' for the purposes of Section 505(3) Taxes Act 1988. That section, together with Section 506, contains curbs on charities which

have tax free income of over £10,000 in a twelve month period. If a charity incurs '*non-qualifying expenditure*' the charity will lose tax relief (and hence pay tax) on the amount equal to its non-qualifying expenditure in the period. *Non-qualifying expenditure* includes '*a non-qualifying loan*'. A '*qualifying loan*' is defined as:

- A loan made to another charity for charitable purposes only.
- A loan made to a beneficiary of a charity.
- Money placed on current account with a recognised banking institution.
- Any other loan which the Inland Revenue is satisfied is made for the benefit of the charity and not for the avoidance of tax.

A loan to a trading company would only fall in the last category. By and large the Inland Revenue accept that if a charity has complied with the Charity Commission's guidelines on making loans, then it will accept the loan was a qualifying loan. This applies whether the charity is registered with the Charity Commission or not. If a registered charity is considering making a loan of more than £20,000, it should consider whether or not it should seek prior clearance from the Charity Commission.

5.8.11 The charity should not subsidise a trading company. It should operate on an arm's length relationship with it. That means that the charity should charge the trading company for its use of the charity's staff, premises etc. The charge should be based on a costs recovery basis only. The charity should not make a profit from operating the charge because otherwise it might pay tax on the surplus because it is not derived from primary purpose trading. The agreement should cover the use of the charity's name, data (if applicable and if compliant with the Data Protection Act), intellectual property and other matters. If the charity and the trading company are part of the same VAT group, the charge will not attract VAT. If they are not part of the same VAT group it will attract VAT if the charity is registered for VAT or has to register as a result of making the supplies to the trading company.

5.8.12 It is normal for the trading company to give away all its profits to the charity under Gift Aid. This means that the trading company does not pay any corporation tax on its profits and the charity receives them tax free. Since the Finance Act 2002, it is possible for a company to retain the first £10,000 of its profits free of corporation tax. Where there are two companies in a group, i.e., where the charity is a company as well as the trading company, then the £10,000 has to be shared out between the two, i.e., they can each have £5,000 of tax free profits each.

The disadvantage with stripping out the profits each year, advantageous though this may be from a taxation point of view, is that the trading company does not build up any reserves or working capital. It is therefore dependent on the charity lending money back immediately after receiving it. The payment and the Gift Aid must be made by a cash payment and not done merely by an inter-company book adjustment, and must be made within nine months of the end of the trading company's financial year *if it is wholly owned by the charity*. If it is not the Gift Aid payment must be made within the trading company's relevant financial year to be tax deductible in that year.

6 Finance and Tax

6.1 Finance

6.1.1 Raising finance for social enterprises

Capitalism has developed a range of financial instruments that have been crucial to its development and success. Their aim has been to maximise the financial rewards to investors.

The aim of social enterprises, whether co-operative, mutual or charitable, is to make goods and services available to those who need them. Attracting investors (and other funders) is a means to this end and the reward payable to them is that necessary to attract the finance.

Surpluses are not distributed, but are retained for application in accordance with the social (or charitable) purposes of the social enterprise. This is described as 'not for profit' operation, though more accurately, it is 'not profit distributing' operation.

The challenges for social enterprises are:

- To seek to use those instruments to create successful enterprises which produce outcomes that are more than just financial; and
- To attract funding which is itself driven primarily by social purposes, rather than the profit motive.

6.1.2 Equity share capital – CLS

The equity capital in a business is the term used to describe the capital held by the proprietors. Classically ordinary share capital issued by companies limited by shares is seen as the equity capital but other types of share, e.g. preference shares, are also part of the equity share capital. That is because dividends – even fixed interest ones paid on preference shares – can only be paid out of distributable profits. Equity capital has a number of key features namely:

- It is paid from generated surpluses (rather than as a cost of the business) – the shareholders only get a reward if there are profits available for distribution by way of dividend. In the lean years they get nothing. If there is a loss brought forward on the balance sheet this must be expunged by saving profits before dividends can be paid. If the company goes into liquidation they get paid out last. On the other hand, high risk can also bring higher reward and hence some investors and owners of shares make fortunes.
- It is patient – the shareholders have to wait for the good times to get their reward (though their investment decisions will be based on the likelihood of the good times materialising).
- Share capital has a positive impact on a company's balance sheet. It is classified as an asset. This is in marked contrast to loans which are treated as a liability. Consequently, a company that is financed by borrowings, e.g. from its parent charity (if a trading company) or from supporters will find it very difficult to borrow money from a bank since the bank will regard it as already being highly 'geared'. On the other hand if it has a reasonable amount of paid up share capital this should give it a stronger balance sheet, providing an asset, based upon which a bank may take security and encouragement in the form of other willing investors.
- Share ownership can bring a sense of involvement and consequently some companies encourage share ownership among staff, although one has to be careful to ensure that staff members' financial positions are not jeopardised by encouraging them to put too many eggs (investment, employment and perhaps pension rights) in one basket.

CASE STUDY 10**Use of society structure to raise capital: The Phone Co-op**

The Phone Co-op is a social enterprise that was set up to provide affordable telecommunication services to the social economy through joint purchase. It started trading in 1997. In five years its turnover has grown from just over £16,000 in 1998 to over £2,300,000 in 2002 and its membership from 20 in 1998 to over 2,000 in 2002.

Originally incorporated as a company limited by guarantee, the Phone Co-op

changed its legal structure in August 1999 to a society for the benefit of the community in order to be able to raise the required capital to finance its intensive growth, while, at the same time broadening its membership base substantially. With a basic offer of £1 nominal shares and a dividend of 4%, the Phone co-op has managed to raise £188,366 since their change of legal structure.

- Share ownership is increasingly widely understood following the popularity of the privatisation of nationalised industries.
- Shares are potentially transferable, thereby allowing an investor to realise his or her investment. However, in the case of a private company this can be difficult. It is highly unlikely that any social enterprise will be a company quoted on the stock market. Many private companies' Articles of Association contain severe limitations on the ability of the shareholders to transfer their shares. Often the directors have a complete veto over allowing share transfers. However some capacity to enable shares to be sold can be introduced by the company participating in a share sale matching scheme such as one run by Triodos Bank Plc. There are some other similar matching services offered for private company shares in certain circumstances.
- Shares in a CLS can be highly flexible and just because they are synonymous with capitalism should not mean that they cannot be adapted for use by social enterprises. Unlike bank loans dividends on ordinary shares or preference shares can only be paid if there are profits available for distribution. Moreover, it is possible to make that threshold higher so that the Articles can stipulate that profits are only

distributed after the company has retained a minimum sum for reinvestment so as to ensure that the long term interest of the company is attended to in front of the needs of the shareholders. On the other hand this should not be taken too far because even social investors need a reward!

6.1.3 Share Capital – Societies

The same arguments apply to a degree to shares issued by a society, but subject to:

- The limitation of £20,000 per investor.
- The fact that however many shares the investor holds he or she has only one vote.

6.1.4 Loans and Debt

- The most common way in which social enterprises are financed is by simple loans whether from banks, specialist finance providers (such as community development finance institutions, CDFIs) or from supporters. Such loans can be either secured or unsecured. A bank will almost certainly demand security which can take the form of a charge over any property. In the case of a company or society this would be a fixed and floating charge (see chapter 2). In addition, the bank may well want personal guarantees from directors, management committee

members or other supporters. It is possible that you may be able to make use of the Government backed Small Firms Loan Guarantee Scheme (See Annex 2 for contact details). In the case of a society its maximum borrowing limit must appear in its rules.

- CDFIs are financial organisations that facilitate access to loan finance to social enterprises, voluntary organisations and other community groups who have difficulties accessing mainstream sources of finance. The Community Development Finance Association can provide you with information on how to contact a CDFI in your area. (See Annex 2 for contact details).
- If you borrow money from individuals they may be less demanding than the bank in terms of security required, etc., but will still want to know how they are going to be repaid.
- Loans from individuals may be based on a small network of workers and close friends supporting the business or they may be much more sophisticated and based on a bond issue. Unfortunately 'bond' is a word with a number of legal meanings, but in this sense it means a written obligation from a company to repay a loan. Under a bond issue individuals lend money to the borrower and in return

CASE STUDY 11 Loans and debt for social enterprises: Bookprint 2000

The founding staff of Bookprint 2000 were originally employed by Remploy, the largest employer of disabled people in the UK. After Remploy underwent a restructuring in 1999 and decided to close their book binding factory in South Wales, the staff, the majority of whom had some disability, were facing redundancy in an area of high unemployment. Eight of the redundant staff decided that they would try to take over the business. They registered as a workers' co-operative limited by shares, each putting in £5,000 of their redundancy money as share capital, and with this, plus additional loan finance, they bought the equipment from Remploy when it came up for auction.

In order to do so, they managed to raise a start up finance package of £105,000, consisting of:

- £40,000 share capital
- £40,000 loan over five years at 12% interest from Industrial Common Ownership Finance (ICOF), a national community development financial

institution targeting mainly social enterprises (See Annex 2 for contact details). The loan is secured through debenture on the machinery bought with the loan and which is repaid in monthly instalments

- £15,000 loan over five years from Barclays bank at 10% interest which is secured through the Small Firms Loan Guarantee Scheme
- £5,000 'soft' loan over three years at 6% interest from Neath and Port Talbot County Council
- £5,000 'soft' loan over three years at 6% interest with a one year capital repayment holiday from BP Darcy, a loan fund set up for enterprises when BP closed its operations in the area

Operations started in 2000 with the eight shareholder staff and by the end of the year Bookprint 2000 was employing 15 staff. Today they continue to fulfil their aim of providing local employment with an emphasis on the long-term unemployed and the disabled.

receive a 'bond' which confirms the amount of the debt, how much and when interest will be paid and the redemption date, etc. The bond can be secured in which case, in the case of a company or society, the borrower issues a debenture or mortgage over its assets to secure its liabilities to the bond holders. The security is normally held by a trustee on behalf of the bond holders. This means that if the borrower is in financial difficulties the bond holders can appoint a receiver who can take possession of the property that is mortgaged to the bond holders, sell it and pay off the bond holders out of the proceeds of sale. Where bonds are secured by debenture they are often called '*debenture stock*'. An unsecured bond is a much higher risk as the bondholders will have no prior claim if the company goes into insolvent liquidation.

6.1.5 Financial Regulation

Seeking investors for a social enterprise is a regulated activity governed by the Financial Services and Markets Act 2000 ('FSMA 2000') and overseen by the Financial Services Authority.

Deposit taking is also regulated under the FSMA 2000 as a banking activity, but withdrawable shares of societies are exempt from such regulation.

When planning how to approach potential investors, the applicable level and degree of regulation must be ascertained. For example, approaching a bank for financial support is as straightforward as it seems, because the regulatory regime recognises that institutional investors are experts in the field not requiring regulatory protection. In contrast, as a means to protect the inexperienced and unwary, approaching an individual with the suggestion that they might wish to invest in a new venture (even one with social objectives) is a criminal offence, except in particular defined circumstances.

'Investment', for these regulatory purposes is widely defined and includes loans as well as equities.

The following levels of regulation exist, the latter two of which are more likely to apply to social enterprises:

- Listed companies making public offers of securities must comply with applicable listing rules (*FSMA 2000 Part VI*).
- Unlisted companies making public offers of securities, including shares and debentures, must issue a prospectus or similar document, unless a specific exemption from the requirement applies (*Public Offer of Securities Regulations: Statutory Instrument 1995/1537- 'the POS Regulations'*).
- All other invitations or inducements to invest, known as 'financial promotions' (including where an exemption applies in relation to prospectus requirements), are prohibited, unless issued, or approved, by someone authorised to give financial advice, or, unless a specific exemption from the prohibition applies (*Section 21 FSMA 2000*).

If the POS Regulations apply, professional advice will be required in relation to the required offer document. However, social enterprises, in many cases, will be covered by one of the 21 exemptions set out in Regulation 7 of the POS Regulations.

Securities issued by charities, housing associations, industrial and provident societies and other non-profit making bodies with social objectives are specifically exempt. Other exemptions cover offers:

- To those who may reasonably be expected to understand the offer and the attendant risks (e.g. investment professionals, public authorities).
- To groups of connected individuals (e.g. members of a club, employees of a company).
- Which are part of a larger commercial transaction (e.g. a takeover, or merger).
- Which are relatively small scale (e.g. where sent to 50 or fewer recipients, or where the total consideration payable is less than ecu 40,000).

Where the POS Regulations do not apply, the practical requirement under section 21 FSMA 2000 will be for an accountant to confirm, formally, that the terms of the 'financial promotion' are fair and not misleading. Sixty exemptions to this requirement are set out in the FSMA 2000 (Financial Promotion) Order: Statutory Instrument 2001/1335. The Financial Services Authority publishes guidance on its interpretation.

There is a specific exemption applicable to financial promotions of loan investments by industrial and provident societies, but otherwise no specific exemptions for bodies with social objectives.

There are again exemptions in relation to promotions to the reasonably expert, groups of connected individuals and those party to a larger commercial transaction.

In this case the reasonably expert include 'high net worth' individuals and 'sophisticated' investors, provided they have been certified as such by their accountants, 'high net worth' companies and other organisations and 'high value' trusts. Broadly, the thresholds for 'high net worth' are:

- Individuals: annual income of £100,000, or net assets of £250,000.
- Companies with fewer than 20 members: net assets or called up share capital of not less than £500,000, or otherwise of not less than £5 million.
- Unincorporated associations or partnerships: net assets of not less than £5 million.
- Trusts: aggregate cash and investment assets of £10 million.

An important question is: what level of formality turns a casual approach into a regulated financial promotion? The answer is potentially not much and one should err on the side of caution. However, generally:

- Where individuals have genuinely embarked on a common initiative, they will not be making regulated financial promotions to each other as the initiative develops.

- A preliminary conversation, without initial promotional intent, will not involve a financial promotion until matters proceed to the next stage.
- A financial promotion does not occur where information is non-specific in the nature of a general advertisement, or information is provided on a purely factual basis.

Please note that this is necessarily a general description of this area and specific advice should be taken in relation to specific instances.

6.1.6 Investment in equities or loans by charities

Many social enterprises are charities and therefore it is perfectly possible for grant making trusts or other charities to support them by grants or donations provided the donor has charitable objects that are identical to or similar to those of the charitable social enterprise. If this is the case it will also be possible for the grant making trust not to give money to the social enterprise but to lend it money, not so as to obtain a financial return as if this were a financial investment, but as a form of social investment. As a social investment the grant making trust will be able to make the loan either at a lower or nil rate of interest and with perhaps a longer period for capital repayment.

In some cases charitable social enterprises are established as companies limited by shares, e.g. Charity Bank. In this case it is possible for charities to purchase shares in the capital of the charitable social enterprise.

In other cases social enterprises are not charities but charities may wish to support them. This may well be possible depending on the objects of the charity. Charities are not obliged just to support other charities with similar objects. They can support non charities that carry out the charitable purposes of the charity. Hence if a social enterprise is working with unemployed people and developing their skills, etc., so as to equip them to get back into the work place it will be perfectly possible for a charity to put together a social investment programme for that social enterprise.

This could include:

- A loan at a lower rate of interest.
- Possibly the purchase of shares in the company (if it is a company).

In either case the charity will need to have an exit strategy which allows it to demand its money back if the non charity starts to change its business and, for example, ceases to work with unemployed people and moves its market so that it is no longer fulfilling a public or charitable purpose but a private one for the benefit of its staff and investors. Alternatively a social enterprise might be achieving a mix of charitable and non charitable goals and a charity may be prepared to lend it money on the basis that it only expects an appropriate return on the investment in so far as that is supporting the non charitable activities and it accepts a nil or low rate of return from the money that goes towards supporting the charitable activities. Again the charity will need to think about exit strategies.

6.1.7 Asset transfer

Another way a social enterprise might be supported is to be given assets, e.g. by a local authority. Social enterprises should be careful, in this case, to ensure that what they are receiving is genuinely an asset and not a liability. For example, a building may be more trouble than it is worth and may cost more money to put it into repair than was anticipated. From the point of view of the donor of the asset it will want to make sure that the asset will be used long term for the social purposes for which it has been given and cannot be suddenly applied for private benefit by a quick sleight of hand. The transferor will almost certainly demand strict legal controls to ensure that this does not happen.

6.1.8 Retained profits

An obvious source of finance for any business is retention of profits. In the case of a charitable social enterprise retained profits will not be subject to corporation tax. In the case of a non charitable social enterprise they will be unless the profits are used for investment that attracts capital

allowances. In the case of a company limited by guarantee which does not have the capacity to issue shares, and therefore does not have shareholders, it will be entirely dependent upon loans for finance and retaining profits will play a vital part in developing its financial health.

6.1.9 Grants

Where social enterprises are charities then they will be eligible for grants from grant making trusts. Non charitable social enterprises with appropriate non profit distribution clauses may be eligible to obtain grants from charities for restricted charitable purposes subject to appropriate grant conditions which may or may not be onerous.

Social enterprises may be able to tap into a range of government funding, e.g. regeneration and neighbourhood renewal funding available through Regional Development Agencies, Local Authorities, Local Strategic Partnerships and Regional Government Offices. European sources of finance, e.g. European Social Fund, may also be available to social enterprises. Furthermore, social enterprises may also be able to borrow money from a clearing bank under the Department of Trade and Industry backed Small Firms Loan Guarantee Scheme (See Annex 2 for contact details for all of these bodies).

6.2 Taxation

6.2.1 Corporation Tax

Unincorporated associations, industrial and provident societies and limited liability companies pay corporation tax on their profits. The current corporation tax rates (2002) are:

- First £10,000 of profits 0%
- £10,000 to £300,000 19%
- £300,000 + 30%

Corporation tax applies to both profits and chargeable gains.

6.2.2 The Mutuality principle

For some social enterprises the mutuality principle is extremely important. This provides that where profits are derived from trade between members of an organisation, those profits are not subject to tax as they have been derived from mutual trading.

6.2.3 Rate relief

Charitable social enterprises will be able to enjoy 80% mandatory rate relief (see Chapter 5). Non-charitable social enterprises may be eligible to apply for discretionary rate relief, on the basis of their social purposes and (if applicable) non-profit distributing status.

6.2.4 VAT

There is no general exemption from VAT for social enterprises which undertake trading activities. The trading activities of many social enterprises will fall within the definition of business supplies for VAT even though they do not pursue a 'profit motive'. VAT is a tax on *turnover*, not profit. Whether VAT is payable or not usually depends on the nature of what is supplied and not on the status of the supplier. Social enterprises have to pay VAT on goods and services which they purchase, just like anyone else. VAT paid on purchases is '*input tax*'. The problem for some social enterprises is that if the purchase is in connection with an exempt supply by the social enterprise it will not be recoverable. A business is required to register for VAT if it makes taxable supplies of more than the VAT registration threshold in any year (£55,000 for 2002/3). Where a business is registered for VAT it must charge output VAT on the taxable supplies of goods and services that it makes but it can then reclaim input VAT on purchases made in connection with such supplies.

'A taxable supply' is defined as "*a supply of goods or services made in the United Kingdom, other than an exempt supply*". This includes zero rated supplies which counts towards the £55,000 per annum VAT registration threshold. There are a number of exemptions from VAT which are significant for social enterprises. The list of exempt activities is detailed and covers supplies such as:

- Education

- Health and welfare

If a supply is exempt from VAT certain consequences follow:

- No VAT is charged on such supplies.
- Any input VAT incurred in making an exempt supply is not recoverable.
- Exempt supplies are ignored for the purposes of calculating whether or not a trade is making taxable supplies and turnover from exempt supplies does not count towards the VAT registration threshold.

Hence if a social enterprise is trading but only making exempt supplies it will not be able to register for VAT whatever its turnover. The type of exempt supplies which are most likely to be provided by social enterprises are education, research and vocational training and health and welfare services.

Educational supplies

Education is exempt from VAT if it is provided by an eligible body. An eligible body is one:

- Which is banned from distributing and does not distribute any profits it makes; and
- Applies any profits it makes from supplies of education research or vocational training to the continuance or improvement of such supplies.

Whether or not a social enterprise is an eligible body will therefore depend on whether or not it has a non profit distribution clause and the scope of its objects. If they allow the enterprise to carry on other activities apart from educational ones then it will not be an eligible body. This may be an advantage because it will allow the social enterprise to recover input VAT although it will have to charge output VAT.

Welfare Services

This exemption only applies to social enterprises which are charities. The supply otherwise than for a profit by a charity of welfare services and of goods supplied in connection with that is exempt. Welfare services means services directly connected with:

- The provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons.
- The protection of children and young persons; or
- The provision of spiritual welfare by a religious institution as part of a course of construction or a retreat.

Zero rated supplies

These apply to any form of social enterprise.

Where a VAT registered person supplies goods or services and the supply is zero rated then no output VAT is chargeable but input VAT can be recovered. The crucial areas for social enterprises will include the sale of food, books, talking books for blind and handicapped people, wireless service for the blind, construction and building, transport, dispensing drugs, clothing, footwear and special concessions for charities.

6.2.5 Tax relief for investment in social enterprises

- If a social enterprise is a charity then the tax reliefs for donations to charities will apply if a supporter wishes to make a donation (see Chapter 4). If a supporter wishes to purchase shares in a social enterprise or make a loan to it the only way in which he or she can do this in a tax efficient manner would be to do it via another charity so that he or she has obtained tax relief in making the donation to that charity and that charity then invests in shares in or loans to the social enterprise. For example the investor may have a Charities Aid Foundation (CAF) account and could use funds in that account to invest in the charitable social enterprise. Whilst in theory this route could also be used for investment in a non charitable social enterprise which is limited to use for charitable purposes this may be difficult in reality.
- If the social enterprise is not a charity then there are no tax reliefs available. It might be possible to use the Enterprise Investment

Scheme, which gives tax relief for investment in new shares in qualifying companies although this only applies to investment in ordinary shares.

6.2.6 Community Investment Tax Relief

If a social enterprise or business is located in or serves a designated disadvantaged community then income or corporation tax relief may be obtained for investments made through an accredited community development finance initiative (CDFI). The investment must be held for at least five years, and may be in the form of a loan or subscription for shares or securities in the CDFI. Relief of 5% per annum of the amount invested for a period of five years may be claimed, making a total relief of 25%, although the tax liability may not be reduced below zero by this means thence a social enterprise established as a CLS, CLG or society might be able to raise funds from a CDFI.

7 Ways Forward

7.1 Strategy Unit Report

The government's Strategy Unit published a report "Private Action, Public Benefit – a review of charities and the wider not-for-profit sector" in September 2002. This is a consultation document that looks at the legal framework for charities, voluntary organisations and social enterprises. There are a number of key recommendations that will affect social enterprises.

7.1.1 Community Interest Companies (CICs)

It is proposed that provision is made for potential social enterprises to set themselves up using a new legal entity, to be called the Community Interest Company (CIC). The CIC will be a type of company and will allow organisations to ensure that their assets are dedicated to public benefit purposes without applying for charitable status. It is proposed that the CIC will have the following features:

- Protection of assets against distribution to members or shareholders.
- Ability to choose the limited by guarantee or by shares format, with full adherence to UK and European company law and guidelines, including rules on insolvency, accountancy, and governance.
- Ability to issue preference shares with a fixed rate of return (this applies to both the limited by guarantee and limited by shares models).
- Increased requirements in terms of transparency and accountability compared to other companies.
- A requirement to have a clause in the constitution setting out the objects of the company.
- A check at the point of registration that the objects of the organisation are in the public

and community interest, with subsequent changes being subject to regulatory approval.

7.1.2 Branding

The DTI's Social Enterprise Unit will consult on the feasibility and value of a branding scheme in order to identify whether this is something that the government can take forward.

7.1.3 Review of charity law

It is proposed that the four heads of charity are replaced by ten new heads. The effect of this is to set out a framework within which the definition of charity can evolve. The ten heads are:

1. The prevention and relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. The advancement of health.
5. Social and community advancement.
6. The advancement of culture, arts and heritage.
7. The advancement of amateur sport.
8. The promotion of human rights, conflict resolution and reconciliation.
9. The advancement of environmental protection and improvement.
10. Other purposes beneficial to the community.

It is also proposed that all charities should demonstrate that they are for public benefit.

The effects of this should not be overstated, in fact, the new definition is mainly a confirmation and clarification of the existing position, with slight expansion and clarification in a few areas such as sport, prevention (in contrast to relief) of poverty and promotion of human rights.

7.1.4 Trading

It is proposed that charities should be allowed to undertake non primary purpose trading without setting up a separate trading company. This will be subject to a duty of care, which includes a duty to consider the best structure so as not to expose the charity's assets to significant risk and to take appropriate professional advice. If this is implemented, it will help small charities in particular who wish to undertake prudent trading within the charity. For larger organisations, it is likely that they will still want to set up separate trading companies to ring-fence risk.

7.1.5 Charitable Incorporated Organisation (CIO)

A new form of incorporated legal form is proposed for charities. This will have an oligarchy or membership format (see chapter 2). It will have the advantages of limited liability and legal personality, without the dual regulation from Companies House and the Charity Commission, as the Commission will register and regulate CIOs.

7.1.6 Industrial and Provident Societies

The name Industrial and Provident Society will be dropped. Societies for the Benefit of the Community will be officially renamed 'Community Benefit Societies' and bona fide co-operatives will be renamed 'Co-operatives'. There will also be clarification about the ability for Community Benefit Societies to have different classes of membership, whilst retaining the one member one vote principle.

The threshold for dissolving and de-mutualising will be raised.

Importantly, Community Benefit Societies will have a choice on incorporation of including a provision to protect their public purpose and prohibit conversion to a co-operative or company in the future.

7.2 Proposed Co-operatives and Community Benefit Societies Bill

This Private Members Bill (see 4.10.1) had its second reading on 31 January 2003. It aims to introduce amendments to IPSA to bring it in line with various aspects of company law. The Bill, if enacted, would also allow community benefit societies to entrench provisions in their rules preventing distribution of assets to members. This would allow societies the option of permanently dedicating their assets for public benefit.

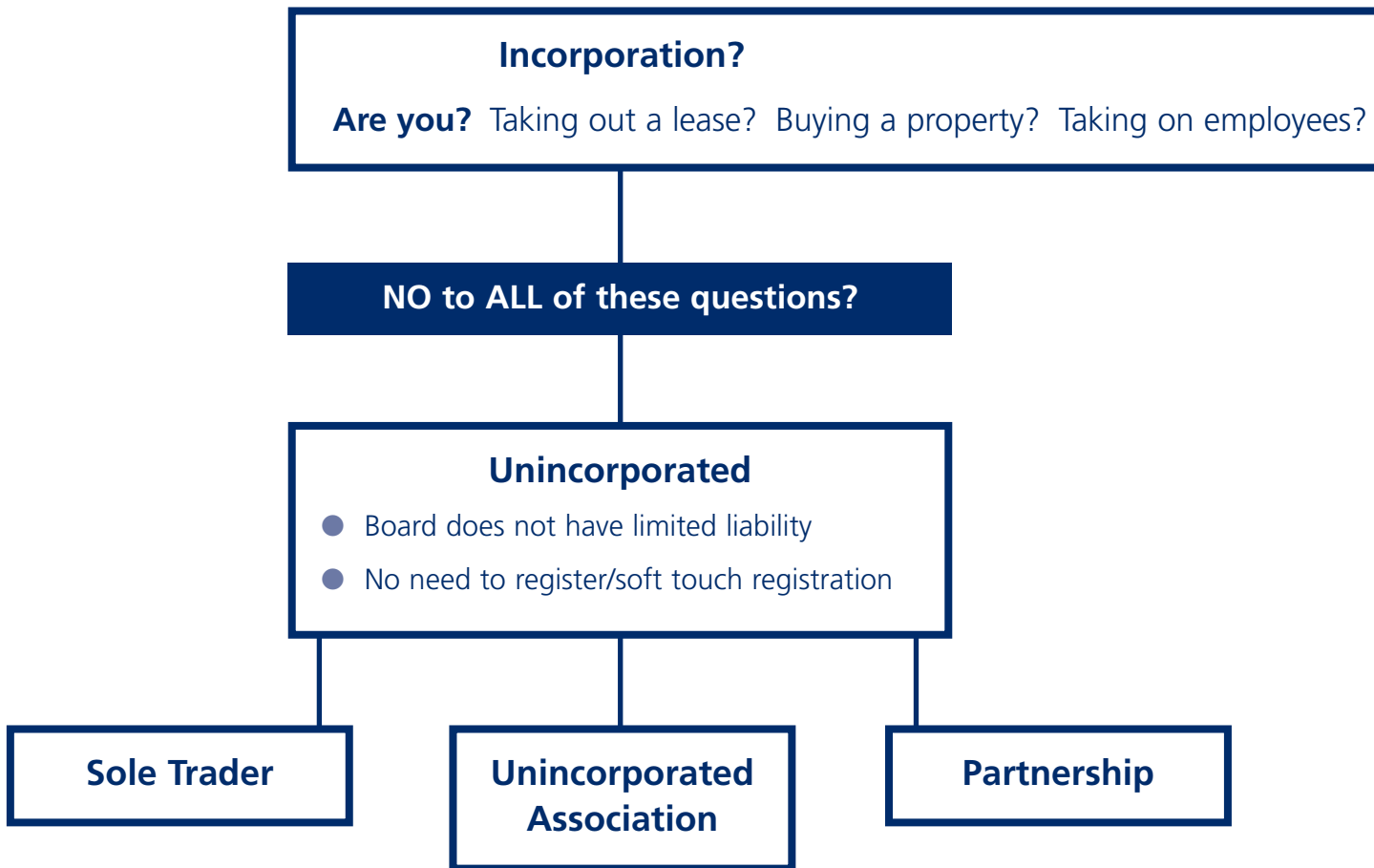
Annex 1

TABLE COMPARING LEGAL FORMS

Choosing / Planning your structure

	Company limited by shares	Company limited by guarantee	Society for the benefit of the community	Bona-fide co-operative	Unincorporated Association
Incorporated with separate legal identity?	Yes	Yes	Yes	Yes	No
Limited liability for members?	Yes	Yes	Yes	Yes	Members are unlikely to incur liability unless there is an indemnity in the constitution
Limited liability for directors/ committee?	Yes	Yes	Yes	Yes	No
Constitutional document?	Memorandum and Articles of Association	Memorandum and Articles of Association	Rules	Rules	Various names can be used, e.g. constitution, rules
Objects	Any	Any	Must be for the benefit of the community	Must follow co-operative principles	Any
Charitable?	Usually not	Can be	Can be	Usually not	Can be
Regulator?	Companies House	Companies House	FSA	FSA	None
Registration with regulator?	Yes	Yes	Yes	Yes	No
Fees for registration?	£20	£20	£100 – £950	£100 – £950	N/A
Debt financing available?	Yes	Yes	Yes	Yes	Yes
Equity financing?	Yes	No	Not conventional equity	Not conventional equity	No
Protection of social purpose?	None unless charitable, but some safeguards can be built into the constitution		FSA has to approve rule changes, and will protect purpose		
Membership voting	Usually one share one vote, so voting is weighted in accordance with the size of shareholding	Usually one member one vote	Usually one member one vote	One member one vote	As per the constitutional document – usually one member, one vote
Stakeholder involvement?	Possible if built into the structure explicitly			Normal	

Choosing a Legal Structure – Decision Tree



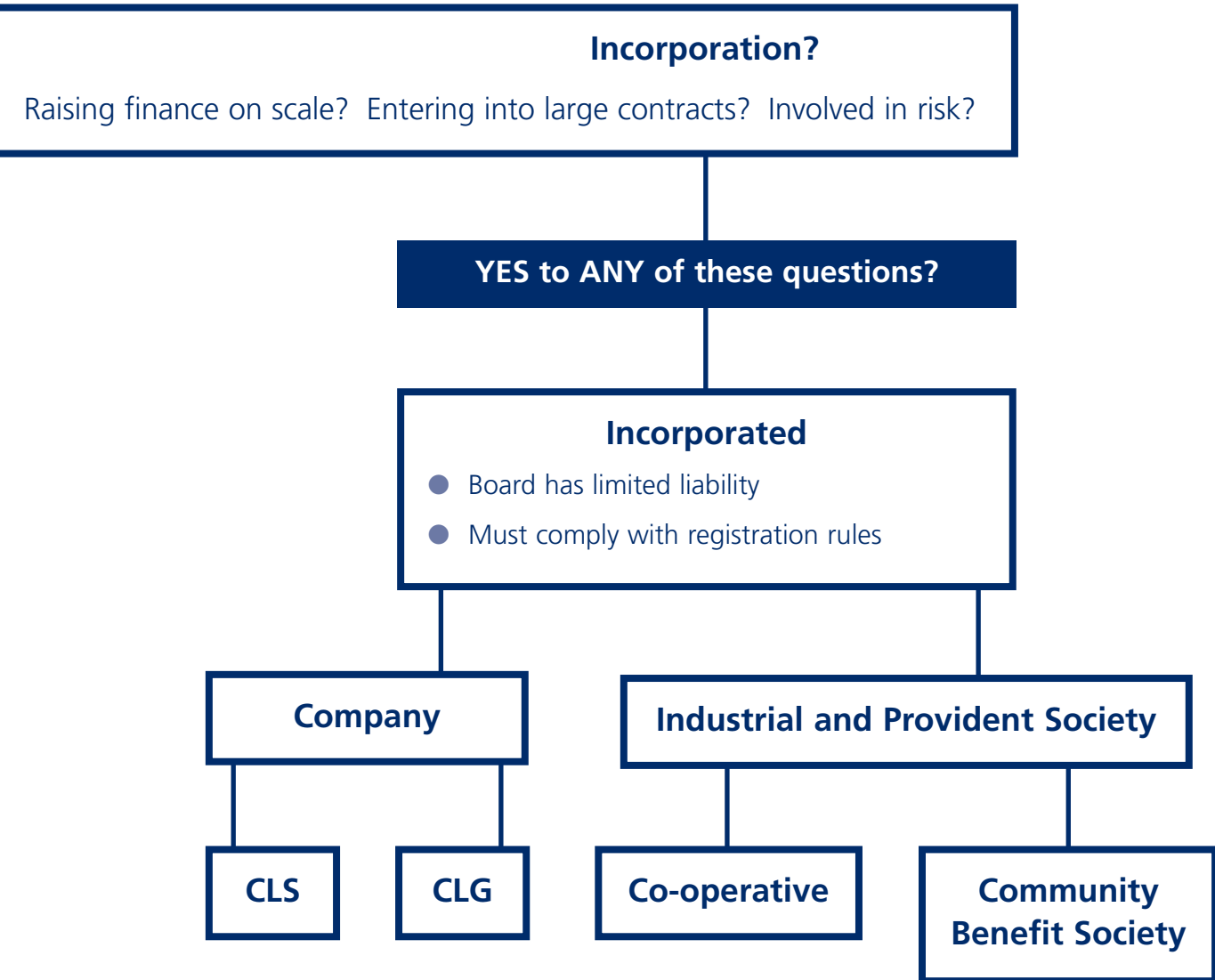
a) Social Enterprise

Sole Trader:	Unlikely to be a social enterprise
Unincorporated Association:	Can be a social enterprise
Partnership:	Unlikely to be a social enterprise

b) Charitable status*

Sole Trader:	Cannot obtain
Unincorporated Association:	Can obtain
Partnership:	Cannot obtain

* For more details on charitable status, please see page 46.



a) Identity/ Branding

- CLS: Business
- CLG: Charity/Voluntary Sector
- Co-operative: Mutual
- Community Benefit Society: Mutual, benefit for communities

b) Charitable Status*

- CLS: Unlikely to obtain
- CLG: Can obtain
- Co-op: Unlikely to obtain
- Community Benefit Society: Can obtain

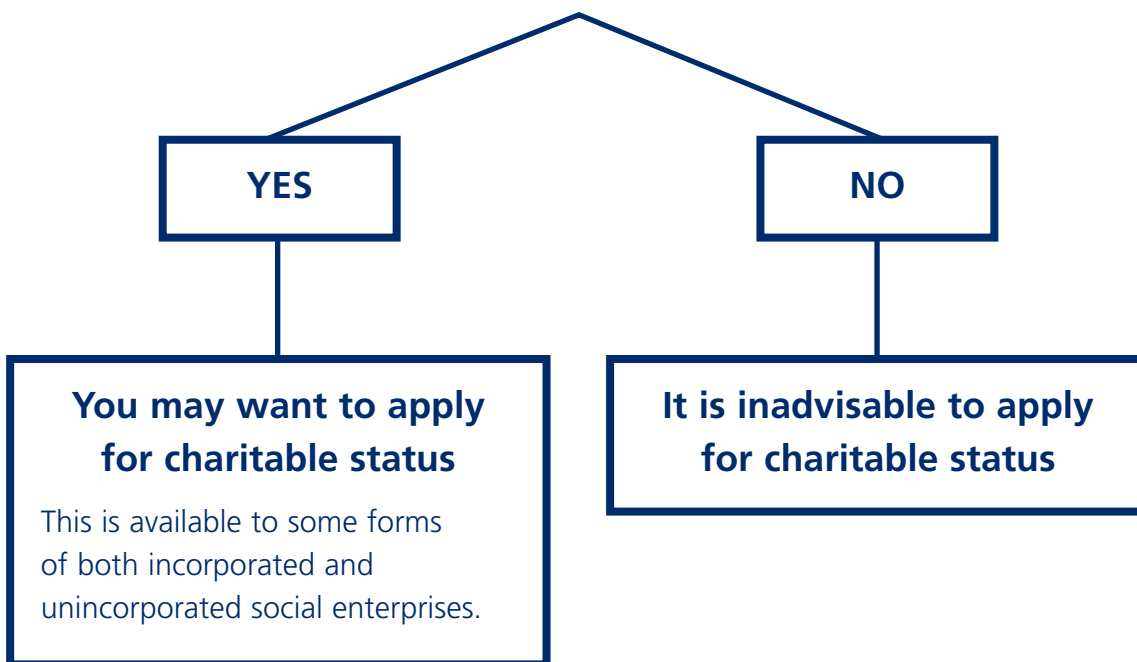
c) Raising Finance

- CLS: Allows finance to be raised through share issue. Loans available. Grants possible in some cases.
- CLG: Doesn't allow finance to be raised through share issues. Loans available. Grants often available.
- Co-operative: Allows finance to be raised through share issue. Loans available. Grants possible in some cases.
- Community Benefit Society: Allows finance to be raised through share issue. Loans available. Grants often available.

As a social enterprise, do you want

Charitable Status?

- Is your social aim charitable?
- Is the nature of your activity likely to attract grants or donations?
- Are you confident that charitable status will not interfere with your trading activities?
- Is your vision of social enterprise **un**related to the economic participation of your stakeholders?



Annex 2

Solicitors specialising in social enterprise

Bates, Wells and Braithwaite

Cheapside House, 138 Cheapside
London EC2V 6BB
Tel: 020 7551 7777 www.bateswells.co.uk

Cobbetts Solicitors

Ship Canal House, King St, Manchester
Lancashire, M2 4WB
Tel: 0161 833 3333 www.cobbetts.co.uk

Wrigleys Solicitors

19 Cookridge Street, Leeds
West Yorkshire LS2 3AG
Tel: 0113 244 6100 www.malcolmlynch.com

Consultants / advisors specialising in social enterprise

Baker Brown Associates

31 Ambrose Road, Bristol BS8 4RJ
Tel: 0117 925 0824 www.bakerbrown.co.uk

Business Link (business advice service)

Tel: 0845 600 9006 www.businesslink.org

Charlie Cattell Consultancy & Training

35 Craven Lane, Gomersal
West Yorkshire BD19 4QX
Tel: 01274 878989

Gowland Taylor Associates

57 Cowley Road, Ilford IG1 3JJ
Tel 020 8491 5830
Email: mick.taylor@geo2.poptel.org.uk

The Guild – Consultants for the Social Economy

Burlington Buildings, 11 Orford Place
Norwich, Norfolk NR1 3RU
Tel: 01603 615200
E-mail: services@the-guild.co.uk

Key Contacts

Association of British Credit Unions Ltd (ABCUL)

Holyoake House, Hanover Street, Manchester
Lancashire M60 0AS
Tel: 0161 832 3694 www.abcul.org

Association of Local Co-operative Development Agencies

c/o Co-operatives UK, Holyoake House
Hanover Street, Manchester M60 0AS
Tel: 0161 246 2900 www.cooperatives-uk.coop

The Co-operative Group

PO BOX 53, New Century House
Manchester, Lancashire M60 4ES
Tel: 0161 834 1212 www.co-op.co.uk

Co-active Ltd

25 Wolseley Close, Plymouth PL2 3BY
Tel: 01752 500 888 www.co-active.org.uk

Community Action Network

The CAN House, Mezzanine Floor
Elizabeth House, 39 York Road, London SE1 7NQ
Tel: 020 7401 5310 www.can-online.org.uk

Confederation of Co-operative Housing

Unit 19, 41 Old Birley Street, Hulme
Manchester M15 5RF
E-mail contact: info@cch-uk.org www.cch-uk.org

Co-operation Black Country

Social Economy House, Victoria Street
West Bromwich B70 8ET
Tel: 0121 553 2620 www.socialeconomy.org

Co-operative Assistance Network Ltd

12 Bellevue Road, Southampton SO2 0AE
Tel: 023 8071 0622 www.co-op-assist.co.uk

Co-operative Forum (Northern Ireland)

Northern Ireland Co-op, 75 Belfast Road
Carrickfergus, Belfast BT38 8PH
Tel: 0800 0686 727
E-mail: customer.relations@co-op.co.uk

Co-operative Solutions Limited

Denmar House, River Way, Harlow CM20 2DP
Tel: 0845 458 1137
Email: co-opsolutions@pop3.poptel.org.uk

Co-operatives UK

Holyoake House, Hanover Street
Manchester M60 0AS
Tel: 0161 246 2900 www.cooperatives-uk.coop

Cymru-Wales Co-operative**Development Agency**

Baltic House, Mount Stuart Square
Cardiff CF10 5FH
Tel: 029 2046 2222

Department of Trade and Industry

1 Victoria St, London SW1H 0ET
Tel: 020 7215 5000 www.dti.gov.uk

Development Trusts Association

2-8 Scrutton Street, London EC2A 4RT
Tel: 08454 588 336 www.dta.org.uk

Employee Ownership Scotland

Robert Owen House, 87 Bath Street
Glasgow G2 2EE
Tel: 0141 554 3797 www.eos-online.co.uk

Financial Services Authority (FSA)

25 The North Colonnade
Canary Wharf, London E14 5HS
Tel: 020 7676 1000 www.fsa.gov.uk

Greenwich Co-operative**Development Agency**

2nd Floor, The Forum@Greenwich
Trafalgar Road, London SE10 9EQ
Tel: 020 8269 4880 www.gcda.org.uk

Hackney Co-operative Developments Ltd

2 Beechwood Road, Hackney, London E8 3DY
Tel: 020 7254 4829 www.hced.co.uk

International Co-operative Alliance

15, Route des Morillons
1218 Grand-Saconnex, Geneva, Switzerland
Tel: (+41) 022 929 88 88 www.ica.coop/ica/

Local Government Association

Local Government House, Smith Square
London SW1P 3HZ
Tel: 020 7664 3000 www.lga.gov.uk

Local Strategic Partnerships

Tel: 0845 850 8800 www.quest-net.org/lsp

Mutual Aid

48 Osborne Road, Brighton N1 6LQ
www.co-op.org/mutualaid/home_map.htm

National Council of Voluntary Organisations

Regent's Wharf, 8 All Saints Street
London N1 9RL
Tel: 020 7713 6161 www.voluntarysector.co.uk

New Economics Foundation (NEF)

Tel: 020 7089 2800 www.neweconomics.org

Regional Development Agencies

www.consumer.gov.uk/rda/info/

Regional Government Offices

www.government-offices.gov.uk

Small Business Service

Kingsgate House, 66-74 Victoria Street
London SW1E 6SW
Tel: 0845 600 9 006 www.sbs.gov.uk

Social Economy Agency (Belfast)

45-47 Donegall Street, Belfast
 Northern Ireland BT1 2FG
 Tel: 028 9096 1115
www.socialeconomyagency.org

Social Enterprise Coalition (UK)

Tel: 020 7401 3166 www.socialenterprise.org.uk

Social Enterprise East Midlands

Nottingham Voluntary Action Centre
 7 Mansfield Road, Nottingham NG1 3FB
 Tel: 0115 934 9550 chris.hill@seem.uk.net

Social Enterprise London

1a Aberdeen Studios, 22-24 Highbury Grove
 London N5 2EA
 Tel: 020 7704 7490 www.sel.org.uk

Social Enterprise Network for Scotland (SENSCOT)

54 Manor Place, Edinburgh EH3 7EH
 Tel: 0131 220 4101 www.senscot.net

Social Enterprise Sunderland

44 Mowbray Road, Hendon, Sunderland SR2 8EL
 Tel: 0191 565 0476 www.hendon-hub.org.uk

Social Enterprise Unit, Department of Trade and Industry

1 Victoria St, London SW1H 0ET
 Tel: 020 7215 0293

Social Firms South East

The Kingsfield Centre, Philanthropic Road
 Redhill, Surrey RH1 4DP
 Tel: 01737 764 021

Social Firms UK

Aspect House, 2-4 Monson Rd, Redhill
 Surrey RH1 2ET
 Tel: 01737 764 021 www.ermis.co.uk

Wales Co-operative Development & Training Centre

Llandaff Court, Fairwater Road, Cardiff CF5 2XP
 Tel: 029 2055 6153

West Midlands Social Economy Partnership

Citib@SE, Lonsdale House, 52 Blucher Street
 Birmingham, West Midlands B1 1QU
 Tel: 0121 616 5064

Sources of Finance**Aston Reinvestment Trust**

The Rectory, 3 Tower Street, Birmingham
 West Midlands B19 3UY
 Tel: 0121 359 2444 www.reinvest@gn.apc.org

Barclays Bank

Barclays Financial Inclusion Team
 Rachael Barber
 Social Banking Manager
 Tel: 020 7699 5775 www.society.barclays.co.uk

Bridges Community Ventures Ltd

1 Craven Hill, London W2 3EN
 Tel: 020 7262 5566 www.bridgesventures.com

Change

Osborn House, Osborn Terrace, London SE3 9DR
 Tel: 020 8852 9181 www.changefinance.org.uk

Charity Bank

PO Box 205, 25 Kings Hill Avenue
 West Malling, Kent ME19 4DD
 Tel: 01732 520029 www.charitybank.org.uk

Community Development**Finance Association**

The Leathermarket, 11-13 Weston Street
 London SE1 3ER
 Tel: 020 7820 1282
 E-mail: info@cdfa.org.uk

Co-operative Bank

New Century House, Manchester M60 4ES
 Tel: 08457 215 215 www.co-operativebank.co.uk

Enterprise Investment Scheme

http://www.inlandrevenue.gov.uk/stats/ent_invest_scheme/eis_b_1.htm

Funding Information

www.fundinginformation.org

Go-East Ventures Ltd.

Universal House, 88-94 Wentworth St
London E1 7SA

Tel: 020 7377 8821 www.goeast.org

Greater London Enterprise

28 Park Street, London SE1 9EQ

Tel: 020 7403 0300 www.gle.co.uk

Hackney Business Venture

34-36 Dalston Lane, London E8 3AZ

Tel: 020 7254 9595 www.hbv.org.uk

Industrial Common Ownership Finance

227c City Road, London EC1V 1JT

Tel: 020 7251 6181 www.icof.co.uk

Local Investment Fund

123 Minories, London EC3N 1NT

Tel: 020 7680 1028 www.bitc.org.uk

London Rebuilding Society

227c City Road, London EC1V 1JT

Tel: 020 7682 1666 www.londonrebuilding.com

NatWest and Royal Bank of Scotland

Community Development Banking

Level 3, 2 Waterhouse Square

138–142 Holborn, London EC1N 2TH

Tel: 020 7427 9139 www.natwest.co.uk

North Hammersmith Social Enterprise Fund

Tel: 020 8749 9903

Small Firms Loan Guarantee Scheme

Tel: 020 7215 5000 www.dti.gov.uk

Triodos Bank

Brunel House, 11 The Promenade, Clifton

Bristol, Avon BS8 3NN

Tel: 0117 973 9339 www.triodos.co.uk

Unity Trust Bank

www.unity.uk.com

UnLtd

Tel: 020 7401 5305 www.unltd.org.uk

Grant Funding**Association of London Government**

59½ Southwark Street, London SE1 0AL

Tel: 020 7934 9999 www.alg.gov.uk

Bridge House Estates Trust Fund

PO Box 270, Guildhall, London EC2P 2EJ

Tel: 020 7332 3710

www.bridgehousegrants.org.uk

Community Fund

Tel: 020 7587 6600 www.community-fund.org.uk

Co-operative Action

www.co-operativeaction.coop

European Social Fund

www.esf.gov.uk

Peabody Trust

45 Westminster Bridge Road, London SE1 7JB

Tel: 020 7922 5701 www.peabody.org.uk

New Opportunities Fund

1 Plough Place, London, EC4A 1DE

Tel: 020 7211 1800 www.nof.org.uk

Relevant Acts of Parliament

Agricultural Credit Act 1923 Not available on-line

Data Protection Act 1984 Not available on-line

Data Protection Act 1998 <http://www.hms0.gov.uk/acts/acts1998/19980029.htm>

Enterprise Act 2002 <http://www.hms0.gov.uk/acts/acts2002/20020040.htm>

Finance Act 2002 <http://www.legislation.hms0.gov.uk/acts/acts2002/20020023.htm>

Financial Services and Markets Act 2000 (FSMA 2000)

<http://www.hms0.gov.uk/acts/acts2000/20000008.htm>

Housing Association Act 1985 Not available on-line

Industrial and Provident Societies Act 2002

<http://www.legislation.hms0.gov.uk/acts/acts2002/20020020.htm>

Insolvency Act 2000 <http://www.hms0.gov.uk/acts/acts2000/20000039.htm>

Partnership Act Not available on-line

POS Regulations (Public Offer of Security Regulations 1995)

http://www.hms0.gov.uk/si/si1995/Uksi_19951537_en_1.htm

Taxes Act 1988, Section 505(3), Section 506

http://www.legislation.hms0.gov.uk/acts/acts1988/Ukpga_19880001_en_1.htm

Trustee Act 2000 <http://www.hms0.gov.uk/acts/acts2000/20000029.htm>

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'Keeping it Legal – Legal Forms for Social Enterprises' is for people who wish to set up and run successful social enterprises. It is aimed at new starts, emerging social enterprises from the voluntary sector and expanding established social enterprises who may be considering changing their legal structure. It is for social entrepreneurs, managers and board members and for those who are involved in helping or supporting them.

The guide is a practical first step in acquiring basic knowledge about the options for choosing an appropriate legal structure which will suit the needs of a new or expanding social enterprise. It is not intended to replace good expert advice, rather it sets out some of the choices available, the consequences of making those choices and aims to guide the reader in his or her dealings with lawyers, accountants and other business advisors who are providing advice.

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Social Enterprise London (SEL) is the regional agency tasked with the job of promoting social enterprise in London and increasing the size of the social economy. Our work is divided into three broad areas:

- Improving understanding of social enterprise
- Improving business support and
- Ensuring access to finance.

Bates, Wells & Braithwaite is recognised as one of the country's leading firms in the social enterprise and charity field. With over 800 clients in the not-for-profit sector it advises on a wide range of issues from starting up a new organisation or restructuring an existing one to helping organisations with the day to day legal issues that they face including contracting with suppliers and customers, protecting their brand and dealing with staff.

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Barclays recognises the important role it can play in helping to promote financial inclusion and that, through activities that the bank undertakes, can have a positive impact on the lives of people living in deprived areas. The key aim of Barclays Financial Inclusion Team is to improve access to financial services for individuals, small businesses and social enterprises. Barclays is supporting a range of Community Development Finance Institutions (CDFIs), including a number that specialise in lending to social enterprises.

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