

Guide to becoming a Community Interest Company

May 2008

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Regulated by the Solicitors Regulation Authority

INTRODUCTION

Community Interest Companies (“CICs”) were introduced in 2005 to provide a corporate vehicle specifically for “social enterprises”. These include businesses trading for a social purpose and organisations promoting the interests of the community using a business orientated approach.

Many organisations which operate in this way have become CIC’s. Currently over 1,600 have been registered. Examples include: arts projects, community cafés, recycling centres, outdoor bounds centres, and subsidiary arms of charities. The combined reach of CIC’s extends over almost every area of activity that benefits our lives.

If you answer “yes” to any two of the following questions you might consider adopting the CIC model:

- Are you thinking about setting up a business or enterprise that benefits the community?
- Do you run an organisation or business at the moment whose primary aim is not to make profits for shareholders or directors?
- Would you like to be able to draw a salary from an organisation that you are a director/trustee of?

Please note, a CIC is not a charity and has none of the tax breaks enjoyed by a charity.

The purpose of this guidance is:

- For you to learn what a CIC is and how they operate.
- To tell you the pros and cons of becoming a CIC.
- Explain how CICs differ from charities.
- To set out the steps required to become a CIC.

WHAT IS A CIC?

A CIC has two elements:

- It is a limited company, with all the associated benefits and responsibilities, and is regulated by Companies House and the CIC Regulator. A CIC can be a private company limited by guarantee, or by shares, or a public limited company.
- It has inbuilt safeguards to ensure that it operates in the “community interest”.

The “community interest” safeguards include:

- A statutory “asset lock” on the assets of CICs, which ensures that they can only be used for the social purposes of the CIC;
- A “community interest test” which companies must pass in order to be registered;
- A requirement for CIC’s to explain in their annual report how their activities have benefited the community and how they are involving their stakeholders;
- The wide enforcement powers of the CIC regulator responsible for ensuring that CICs comply with their legal requirements.

HOW TO SET UP A CIC

New organisations

The basic procedure for setting up a CIC is the same as for any other company, but there are some additional requirements (with regard to the “community interest” element). The following needs to be sent to Registrar of Companies for England & Wales:

- Memorandum of association and articles of association that comply with the Regulations.
- Form CIC 36, which includes a community interest statement, and a declaration that the company will not be an excluded company i.e. politically motivated.
- Form 10 gives details of first directors and company secretary and the intended address of the registered office.
- Form 12, which is a statutory declaration of compliance with the legal requirements for formation of a company.
- A cheque for £35 payable to Companies House.

Registration at Companies House will not take place until the CIC regulator has approved the application in relation to the community interest elements.

Conversion of existing companies (not charities)

To convert an existing company to a CIC you must send to the Registrar of Companies with the appropriate fee:

- A copy of the special resolutions necessary to alter the memorandum and articles of association so that they conform to the requirements for a CIC memorandum and articles of association.
- A copy of the special resolution changing the name of the company to one of the CIC designations. There is no need to invent a new name unless you want to; a simple change from “Ltd” to “CIC” will be enough.
- Memorandum and articles of association, incorporating the changes made by the resolutions, and that comply with the Community Interest Company Regulations 2005.
- A Form CIC 37, which includes a community interest statement, a declaration that the company will not be an excluded company i.e. not politically motivated and a declaration that the company is not a charity.
- Cheque for £25 payable to Companies House.

Conversion of existing charities

Whilst it is possible for charities to convert to CIC status, legally this is not straightforward, and conversion will result in the loss of tax and other advantages enjoyed by charities.

For existing charitable companies, the above requirements must be complied with. In addition, prior written consent of the Charity Commission must be obtained in relation to the above special resolutions. Consent is required to protect the assets of the charity – to ensure they continue to be used for charitable purposes. The written consent must be sent with the application.

The company will, in relation to its corporate property acquired whilst it was a charity, become a trustee for the charitable purposes contemplated by the objects of the company

immediately before conversion. The Charity Commission will need to be satisfied as to the proposed arrangements before granting consent and again this is an area where professional advice is likely to be required.

An unincorporated charity or trust cannot convert to a CIC. It will be necessary to set up a new CIC and appoint the CIC as a corporate trustee of the assets of the charity.

COMMUNITY INTEREST SAFEGUARDS

Community Interest Test

With regard to the community interest test, the guidance from the Regulator is as follows:

- Most ordinary companies, even those that provide benefits to the community, are set up and run mainly for the benefit of their own members and employees.
- Community Interest Companies are different. Their primary purpose is to provide benefits to the community, rather than to the individuals, who own, run or work in them.
- A company satisfies the community interest test if **“a reasonable person might consider that its activities (or proposed activities) are carried on for the benefit of the community”**.
- The benefit to the community could be from the activity undertaken by the company or from the profits which arise from the business activity.

Asset Lock

A community interest company’s assets can only be distributed for less than the market value to another asset locked body, such as a CIC or charity, or to benefit the community it was set up to serve.

Share dividend cap

For CICs limited by shares, there are restrictions on the payment of dividends to shareholders. Both the complexity of calculating the return and the size of the potential return to investors make investing in a CIC unattractive from a purely commercial perspective.

There is, however, no restriction on the payment of share income to another CIC or charity (“asset-locked” organisation), provided that that organisation is named in the M&A or authorised by the regulator.

The payment of share income to non “asset-locked” organisations (or unauthorised ones) is possible, but subject to limitations (a ‘dividend cap’). The Cap has three elements:

- The maximum dividend per share limits the amount of dividend that can be paid on any given share. Currently, the limit is 5% above the Bank of England base lending rate.
- The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is five years.

DIFFERENCES BETWEEN A CIC AND A CHARITY

Main differences

The Regulator identifies the main differences between charities and CICs as follows:

- Charities must be established exclusively for charitable purposes: CICs can be established for any lawful purpose, as long as their activities are carried on for the benefit of the community.
- Charities have certain tax advantages that CICs do not have. In return for those advantages, charities are subject to more onerous regulation than CICs.
- The CIC legal form was specifically designed to provide a purpose-built legal framework and a “brand” identity for social enterprises that want to adopt the limited company form.
- CICs will be free to operate more commercially than charities (e.g. CICs limited by shares can pay dividends to individual shareholders, subject to a cap), but stakeholders in CICs will still have the assurance of community benefit provided by the asset lock and transparency about their activities through the community interest report.
- A charity may, however, own a CIC and the CIC would be permitted to pass assets to the charity. This for example enables a CIC to run a charity shop and pass all the profits to the charity that owns it.

Why would an organisation prefer CIC status?

There are three main reasons why some organisations may opt for CIC status over becoming a charity:

- They are looking to work for community benefit with the relative freedom of the non-charitable company form to identify and adapt to circumstances, but with a clear assurance to the public and funders of not-for-profit distribution status.
- A director of a CIC can be paid a salary. Members of the board of a charity may only be paid where the constitution contains such a power and it can be considered to be in the best interests of the charity. It means that, in general, the founder of a charity who wishes to be paid cannot be on the board and must give up strategic control of the organisation to a volunteer board, which is often unacceptable.
- The definition of community interest that applies to CICs is wider than the charitable purpose and public interest test for charities. CICs are specifically identified with social enterprise. Some organisations may feel that consequently this is a more suitable option than charitable status.

OTHER LEGAL FORMS

The CIC is only one of several types of legal vehicle which are available to non-charitable social enterprises. The others include:

- Company limited by guarantee or shares (not registered as a CIC); and
- Industrial and Provident Society (either as a co-operative or as a society for the benefit of the community).

It is important that appropriate professional advice is taken before forming a CIC as this structure may not be suitable in all cases.

CONCLUSION

If you are a social entrepreneur or help run an organisation that benefits the community, then you could consider setting up a community interest company. Operating using a business model but keeping the profits for the community purpose could help you achieve your aims.

FOR FURTHER INFORMATION PLEASE CONTACT:

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