



Social Enterprises, CICs & CIOs

A guide for clients

Introduction

A social enterprise is a business that trades for a social and/or environmental purpose, with a clear sense of its 'social mission' being essentially the difference it is trying to make, who it aims to help, and how it plans to do it.

Social enterprises come in many shapes and sizes from large national and international businesses to small community based enterprises but they:

- Aim to generate their income by “selling” goods and services, rather than through grants and donations
- Are set up specifically to make a difference
- Reinvest the profits they make in their social mission

If you meet or aim to meet these criteria and you have these commitments expressed clearly in your governing documents then you are very probably a social enterprise.

Social Enterprise UK considers social enterprises should:

- Have a clear social and/or environmental mission set out in their governing documents
- Generate the majority of their income through some form of trade
- Reinvest the majority of their profits
- Be autonomous
- Be majority controlled in the interests of the social mission
- Be accountable and transparent

Essentially, a social enterprise has a set of operational principles.

- A clear social and/or environmental mission (set out in its governing documents)
- Generating the majority of its income through trade
- Reinvesting the majority of its profits to further the social mission

This is regardless of the form the organisation takes. So if you have these in place – you are acting as a social enterprise. There is no social enterprise regulator as such, although the Social Enterprise UK is a representative body.

Legal structures

Social enterprises use a wide variety of legal forms:

- Community interest company (CIC)

A CIC is a legal form created specifically for social enterprises. It has a social objective that is "regulated", ensuring that the organisation cannot deviate from its social mission and that its assets are protected from being sold privately by the CIC regulator - www.cicregulator.gov.uk

- Industrial and provident society (IPS)

This is the usual form for co-operatives and community benefit societies, and is democratically controlled by its members in order to ensure their involvement in the decisions of the business.

- Charitable Incorporated Organisation (CIO)

This is still a relatively new legal structure providing the benefits of the protection afforded by limited liability (read on for more details on CIOs)

- Companies limited by guarantee or shares

The most common legal structure for standard businesses but many social enterprises also choose them because they are very flexible when it comes to governance and getting investment. To ensure a standard company is a true social enterprise it will need to ensure it has a social mission written into its Memorandum and Articles of Association and is clear about reinvesting its profits.

- Group structures with charitable status

This is again a very common legal form for social enterprises. In part, it is common as increasing numbers of charities are moving away from traditional models of fundraising and becoming more businesslike in order to ensure their sustainability. Partly it is a result of the fact that tax is an important consideration for some organisations where the retention of surpluses is essential. In these cases the tax breaks associated with charitable status can be an important factor and mean that having a charitable structure as part of the group is worthwhile.

This brings out an important point Social Enterprises that are not registered charities are typically liable to corporation tax.

As social enterprises take a range of legal forms so they are regulated by a range of different bodies:

- Community Interest Companies (CICs) are regulated by Companies House and the Community Interest Company Regulator
- Standard companies limited by share and guarantee are regulated by Companies House
- Industrial and Provident Societies are currently regulated by the FCA
- Social enterprises with charitable status and CIOs are regulated by the Charity Commission

Finance Options

Social enterprises re-invest their profits and can't be sold in the same way as standard businesses as they are set up for a social mission, so when it comes to future investment needs, social enterprises can struggle to get investment through the same channels as private businesses.

If a personal investment is made, you can make a reasonable return, but you need to be clear and transparent about it, and seek advice on how you go about this and how to extract your funds.

The most common finance options for Social Enterprises include:

- Grants - Do not need to be repaid, but factors such as flexibility and sustainability must be considered. Grants are available for example from the Big Lottery Fund, trusts and foundations, local authorities and government departments.
- Debt finance - Usually available as a basic loan which will need to be paid back with interest, and these can usually be put to more flexible use than grants.
- Equity finance - Involves the exchange of capital for part-ownership of the business
- Community Finance - Often provided by Community Development Finance Institutions (CDFIs) and Credit Unions who work to address financial exclusion for example.

The Social Investment Forum is a network of Social Investment Finance Intermediaries - organisations working in the space to provide social investment (the provision and use of finance to generate social and financial returns) for social enterprises.

Big Society Capital is the world's first social investment bank with the potential to direct capital to social enterprises looking to start up or expand. Big Society Capital does not finance social enterprises or charities directly - funds are given to Social Investment Finance Intermediaries.

Social Impact:

Social impact is the effect of an activity on the social fabric of a community and well-being of individuals and families.

Measuring your social impact will help you understand, manage and then communicate to your supporters and clients clearly and consistently the social value that your social enterprise has created. This information can be used for a number of very beneficial purposes, the principle of which are:

1. Helping you better understand and target your work
2. Attract investors and retain investor confidence
3. Tender for public sector contracts or sell goods and services

The Charitable Incorporated Organisation (CIO)

This relatively new legal structure provides the benefits of the protection afforded by limited liability. A CIO is regulated only by the Charity Commission and its trustees and members will not usually be personally liable for any debts or liabilities that arise. A CIO has separate "legal personality", so it can enter into contracts, own property, etc. in its own name.

Some charity solicitors advise caution when considering adopting the CIO model as opposed to the more traditional company limited by guarantee. One reason is that the law around CIOs is still very new and problems may arise that were not picked up at an early stage. An example of this is in relation to the legal technicalities that can arise, particularly where a vesting declaration is intended to be used.

The benefit of using a vesting declaration to transfer the assets of an unincorporated charity into a CIO is that any permanent endowment held by the unincorporated charity can be very effectively and efficiently dealt with. Permanent endowment is property of an unincorporated charity (including land, buildings, cash or investments) which the trustees may not spend as if it were income but it must be held permanently.

A CIO or indeed a guarantee charitable company can't hold permanent endowment as part of its corporate property and can only act as corporate trustee, holding the permanent endowment upon the original trusts upon which it was established. A vesting declaration enables the trustees of an unincorporated charity to:

- Vest legal title to the permanently endowed property in the CIO to be held on its original trusts
- Appoint the CIO as trustee for the permanent endowment trust and give it the powers of a trust corporation for that trust.

The CIO and the permanent endowment trust and then treated as a single charity for registration and accounting purposes, so they won't need to register separately or produce separate accounts. In practice, the trustees will operate one charity, although the permanent endowment will need to be held in accordance with its original trusts.

A vesting declaration can't be used though where land is subject to a mortgage or legal charge.

Many grant making organisations for significant capital projects such as property refurbishment secure their funds by way of legal charge on the property.

If the trustee then sought to incorporate the charity as a CIO, a vesting declaration in respect of the building using the model vesting declaration available on the Commission's website is not possible given that the legal charge would exist on the title. Unless this was picked up by the Commission (or possibly the Land Registry when updating title documents), it is likely that this issue might go unnoticed, potentially rendering the transfer of the permanent endowment void.

It is very clear that in considering such matters, proper specialist legal advice should be taken.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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