

NAVIGATING THE MAZE

An introductory guide to legal structure options for social enterprises

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Disclaimer

This guide, commissioned by Selnet, was drafted by Adrian Ashton – a consultant who has been supporting the wider co-operative and social enterprise sector for 3 decades. He has worked with all the regulatory bodies referred to in this guide, and is a recognised authority on social enterprise governance and legal forms by various sector bodies and universities.

However, any information pertaining to the law, legislation, and regulation herein is provided in good faith and for information purposes only. You should always seek professional advice or consult with relevant bodies to discuss legal positions and implications as it relates to you and your enterprise before deciding upon a course of action with regards to the legal structure and form for your enterprise. Such bodies will include: Companies House, the Community Interest Company Regulator, the Financial Conduct Authority, the Charity Commission and HMRC. This is because you will be liable and responsible for the legal form you choose to adopt.

The information supplied was checked in December 2022 and may be subject to change, especially with regards to any specific legislative and/or monetary values, so you are advised to check for updates.

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Introduction and purpose

This document has been prepared to support both social entrepreneurs and existing social enterprises feel better able and more confident in exploring, understanding, and progressing decisions about the legal structure of their respective ventures.

For social entrepreneurs and start-up social enterprises, it serves to introduce the different legal form options that can be considered when incorporating your venture.

For existing social enterprises, it services to support any strategic review that may be taking place in its governance, activities, financing, and operations – to help ensure that the currently legal form remains ‘best fit’, or if not, how an alternate option may help better achieve future plans.

Why bother with spending time understanding legal structures?

Before identifying what the options are, and how they compare to each other, it is important to identify what the key criteria are for considering, when reviewing the different forms.

This is because there can be a lot of information offered about the different forms, but if you are able to prioritise what the key aspects are that you are concerned about, this can help you navigate and make more sense of them, as they might apply to you and your circumstances.

For social entrepreneurs and start-up social enterprises, such considerations might include:

i) **Managing risk**

Many social entrepreneurs begin their enterprises as a sole trader/self-employed. This may be beneficial for many reasons (less cost to register, more flexibility over how activities are managed, etc.). However, this initial status means that the entrepreneur is personally liable for any and all risks associated with their activities – for example:

- a) if they borrow money for it, they are personally liable for repaying it;
- b) if they enter into a contract and cannot deliver the agreed activities, they are personally liable to the commissioning body for any damages that the commissioner may seek to recover from them;
- c) if they sign a property lease for the enterprise to trade from, they are automatically personally liable for ensuring its terms are fully met (for example making sure agreed rent payments are always made to the end of the lease, making repairs to any damage to the property, etc);
- d) if the enterprise starts to employ people, the welfare of those staff is the personal responsibility and liability of the entrepreneur who founded it.

Whilst there may be some insurance policies that could help reduce the exposure to personal risk in the above scenarios, the process of registering (also known as ‘incorporating’) an enterprise with a specific form, means that the enterprise then takes on its own legal identity – and in doing so, legally protects the entrepreneur/others involved from personal risk. This is why some legal forms include the work ‘limited’ – it is a reference to the personal liability of people involved in it being ‘limited’, or protected.

ii) Raising finance

There are many ways in which an enterprise can generate finance or support for its activities or projects. However, different types of finance will be offered by different types of organisations – each of which will have their own rules and requirements which can include your eligibility to apply to them, based on your legal form.

iii) Succession and growth

Over time, it is likely that other people will become involved in the managing and leading of your social enterprise with you. Also, that the services, activities, and products you offer will also grow or change. Different legal forms can offer more protections or flexibility over how far your vision for the social enterprise can be ‘flexed’ in response to these future changes, or how far it remains focused on its initial purpose and activity.

iv) Protecting assets and identity

One of the challenges for social enterprises in the UK is the lack of an overarching legal definition for them – instead they are recognised by being able to exhibit a set of defining characteristics:

- a. They have social purposes, which are achieved through trading.
- b. They have an ‘asset lock’ (in recognition that the things that they come to own over time – money in the bank, vehicles, buildings, etc; have been acquired to help better achieve the social purpose. So should the enterprise be wound up in the future, all such ‘assets’ have to be given back to the community in ways that the social purposes can be continued).
- c. The majority of profits (or ‘trading surplus’) are re-invested in the enterprise. As with the asset lock, this is in recognition of prioritising the social purposes as being more important than any individual or other company’s person’s claims over its success.

Some of the legal form options have these characteristics ‘built in’ by default, but it is possible to design them into any legal form option – hence the importance of this introductory guide, and for entrepreneurs to appreciate the range of options available to them.

For existing social enterprises, who may be wishing to review their registered form, additional or other considerations can be extended to include:

- i) It is not unknown for the initial services and activities a social enterprise starts with, to need to change in the future as communities, society, markets, and needs change over time. The detail of some legal form options will allow either more or less flexibility over how an enterprise would be able to change such trading offers.
- ii) For some social enterprises, their models and bases of accountability to their community may wish to be reviewed.

For clarification, this introductory guide is only concerned with legal form options, not governance structures – but some legal form options will allow more/less formal and protected ways that identified communities or groups of people can have legal voice and power within the enterprise. (Where a social enterprise usually adopts a model that allows for such power to be shared amongst a wider group of people, it is in the interests of helping protect its original vision and purpose for that community).

How to use this guide

As already referenced, this guide is intended to offer the reader an introduction to the legal form options available to social enterprises to incorporate within.

It is intended to help you to feel better able, and more confident, in knowing what questions and themes to prioritise as part of informing your decision-making processes.

To that end, this guide should also be used in conjunction with other resources available to the wider social enterprise sector. At the time of the publication of this guide (December 2022), these include:

- Social Enterprise UK's bi-annual State of the Sector
This is a regular mapping of the wider social enterprise sector. It includes a profiling of not only the different legal forms that social enterprises are using, but also the 'popularity' of each based on how many social enterprises are using each.
- Co-operatives UK's Simply Legal guide
This is a detailed profiling of the different legal form options that social enterprises of all types can use, and also offers additional commentary to the governance implications of each.

However, other detailed guides from other sector and legal bodies are available, and you should research and access all of these that you feel you need to. This is in order to satisfy yourself that you have fully understood the implications and options available to you, and how they relate to your type of social enterprise (based on either its governance, stage of growth, financing, etc).

Structures available to choose from – unincorporated

As highlighted already in the ‘why bother spending time understanding legal structures’ section, many social entrepreneurs and social enterprises begin their journey before they choose a specific legal form to register with.

It can therefore be helpful to delay the final choice of legal form whilst initial trading activity commences to test assumptions in the business model etc.

During this period the usual structural forms that are used are:

Type	Registered with	Need for separate bank account	Risk remains with	Governing document	Advantages in summary	Disadvantages in summary
Sole trader/self-employed	HMRC	N	Individual entrepreneur	n/a	<ul style="list-style-type: none"> Highly flexible Quick to register Easy to wind up Anonymity – only have to file with HMRC: no records available on any public register 	<ul style="list-style-type: none"> Unlimited personal liability Can't protect social enterprise identity Hard to engage in contracts or apply for funding
Community organisation/group	n/a	Y	All members of the group	Set of shared rules (a 'constitution')	<ul style="list-style-type: none"> Highly flexible Confers accountability to a wider group of people than a sole trader can Can seek charitable status 	<ul style="list-style-type: none"> Unlimited personal liability for groups' members Can be harder to seek larger contracts or funding

Structures available for social enterprises to choose from – incorporated

At some stage, a social entrepreneur(s) will identify that they need to go through a process of formally incorporating their venture – usually for the reasons profiled in the earlier ‘why bother spending time understanding legal structures’ section.

Regardless of the option that may be selected from the below options, it should be borne in mind that the process of incorporation not only commits an enterprise to additional regular administrative tasks (such as filing accounts and returns, and need to observe additional compliance and rules), but also that the people who take on roles within it (usually Directors or Trustees) will also have legal responsibilities associated with these roles.

These specific legal duties will vary depending of the specific form, but in general, they require a person in such a role to:

- Always act in the best interests of the enterprise
- Avoid any conflict of interest (such as committing the enterprise to a course of action on the grounds that they would personally financially gain from it)
- Consider the wider implications and impact of decisions being made on different audiences to the enterprise
- Ensure that the enterprise is always compliant with all relevant laws and legislations
- Always seek advice or additional information in the event that they are unsure about a decision they need to make

The below table offers a summary overview of the 3 main ‘groups’ of legal form options. There then follows additional tables that offer more detail about each of the options with these groups.

	Companies	Societies	Charities
Ability to trade	Y – highly flexible	Y – highly flexible	Y – but limited
Ability to borrow money	Y	Y – and can also borrow money from people through ‘community share issues’	Y
Ability to apply for grants	Partly – if a company has shares, then this will preclude it from being able to apply to most grant making bodies	Y	Y
Ability for Directors to be employed or paid	Y	Y	N
Recognition amongst general public, banks, accountants, etc	Y	Varies – but usually needs education to help people understand this form	Y - Highly trusted ‘brand’
Flexibility over changing future trading activities	Y – for companies Partly – for CICs as requires regulator agreement	Y	Partly – requires regulator agreement
Ability to evidence social enterprise characteristics	Partly – for companies (needs changes to rules) Y – for CICs	Y (if a Community Co-operative Society)	Y
Ability to be used by a co-operative	Y – company law is flexible to allow for changes to a company’s rules to adapted to protect this identity	Y – these forms were originally designed for co-operatives	Partly – charities can form with a wider/large legal membership, but the extent to which members can gain economic benefit is more limited
Regulator	Companies House and HMRC – Receive annual accounts, updates to changes in Directors, etc CIC Regulator - receive annual report on impacts and benefits created for defined community	FCA and HMRC - receive annual accounts, updates to changes in Directors, etc, and ways in which Society has engaged its members and benefitted its community	Charity Commission - receive annual accounts, updates to changes in Directors, etc; and annual report on public benefit created

Companies

Companies are a highly flexible legal form with regards to how their rules ('Articles') that guide how they act can be adapted and flexed to reflect the values and priorities of social entrepreneurs.

The Community Interest Company (CIC) was formed as a 'bolt on' status to existing companies – as such CICs are subject to the same benefits and requirements as ordinary companies, as well as the additional features that have been designed into this form. As such a CIC is subject to the CIC Regulator as well as Companies House – and the CIC Regulator holds additional powers in regard to the protection of social enterprise characteristics (which include, but are not limited to, the ability to restrict proposed new trading activities, and the removal of Directors).

	Company ltd by guarantee	Company ltd by shares	CIC ltd by guarantee	CIC ltd by shares
Basis of social purpose	Defined by founders Determined by Directors		Has to be agreed with CIC regulator	
Trading activities				
Ability to apply for grants	Y – but not as many as charities would be able to	N – most grant making bodies will not accept applications	Y - but not as many as charities would be able to	N – most grant making bodies will not accept applications
Flexibility to apply / share / use profits	Defined by founders Determined by Directors		Subject to limits set by the CIC Regulator	
Ability to borrow money	Y	Y – can also raise money through 'equity' (selling of shares to other people for voting rights or share of future profits)	Y	Y - can also raise money through 'equity' (selling of shares to other people for voting rights or share of future profits)
Accountable to	Members (who are agreed by the Directors, and who can also act as Directors)	Shareholders	Members (who are agreed by the Directors, and who can also act as Directors)	Shareholders
Registration	Filing with Companies House		Application to CIC Regulator	

Societies

Societies are traditionally used by co-operative enterprises, and particularly with regards to ventures that are focussed on a defined geographic community (village shop; etc) or a defined body of people who will collectively trade for mutual benefit (such as worker co-operatives).

In contrast to Companies (which can be formed by a single person), Societies require a ‘membership’ – a body of people who share a common purpose and are in agreement as to how the enterprise should be led and managed in best achieving that purpose.

	Co-operative Society	Community Co-operative Society
Basis of social purpose	Determined by members	Has to be agreed with the FCA
Trading activities		Determined by members
Ability to apply for grants	Partly – but if the main purpose is for the benefit of its members, it will be seen in a similar way as a Company with shares	Y – and also has option of seeking charitable tax status for exemption of being taxed on profits generated
Flexibility to apply / share / use profits	Determined by the members	Informed by guidance and legislation from FCA
Ability to borrow money	Y	Y – and also has option of ‘community share issue’
Accountable to	Members	Members (usually people within the wider community that the enterprise is based in)
Registration	Application to FCA	

Charities

Whilst not all charities are social enterprises, many can be – this confusion arises partly from the earlier reference to a lack of overarching legal definition for the sector, and also from not all charities choosing to pursue their social purposes through trading activities (even though they may be able to under the guidance published by the Charity Commission).

Although there are other forms of registering a charity available other than those listed below (charitable company, and unincorporated charity), these have not been included here as:

- 1) The CIO was introduced to replace the charitable company option: it confers the benefits of limited personal liability that a limited company would, but without the need for having to register and report to 2 separate regulators (Companies House and the Charity Commission).
- 2) Unincorporated charities are referred to in the unincorporated form options earlier in this guide.

	CIO (foundation - only has Trustees)	CIO (membership - has Trustees and voting members who are not Trustees)
Basis of social purpose	Has to be based on charity law and agreed with Charity Commission	
Trading activities		
Ability to apply for grants	Y	
Flexibility to apply / share / use profits	N – all surpluses have to be reinvested or gifted in line with social purpose	
Ability to borrow money	Y	
Accountable to	Trustees only	Members
Registration	Application to Charity Commission	

Next steps

As stated earlier, the purpose of this guide is to offer an initial introductory overview of the legal form options available to social enterprises to register with.

It is hoped that its structure and approach have helped you better understand not only the range of options, but also how to best start to consider the relative merits of each with regards to how they may help/hinder your enterprise achieve both its goals, and intended ways of working.

Before making any final decisions, you should speak with a specialist adviser, or undertake further research.

However, there are always options through which a social enterprise can change its legal status after it has originally chosen and registered with it. But depending on what it originally chose and what it may wish to become with mean varying levels of cost and complexity need to be incurred.

Appendix:

Companies House

<https://www.gov.uk/topic/company-registration-filing/starting-company>

CIC Regulator

<https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>

Charity Commission

<https://www.gov.uk/set-up-a-charity>

Financial Conduct Authority

<https://www.fca.org.uk/firms/register-mutual-society>

HMRC

<https://www.gov.uk/log-in-register-hmrc-online-services/register>