

Briefing Paper

Community Interest Companies

December 2007

Introduction

Community Interest Companies (CICs) are limited companies, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. This is achieved by a "community interest test" and "asset lock" that ensures that the Community Interest Company is established for community purposes and the assets and profits are dedicated to these purposes. Registration of a company as a Community Interest Company has to be approved by the Regulator who also has a continuing monitoring and enforcement role.

A Community Interest Company is a new type of company, introduced by the United Kingdom government in 2005. A Community Interest Company is a new type of company, designed for social enterprises that want to use their profits and assets for the public good. It is intended that Community Interest Companies will be easy to set up, with all the flexibility and certainty of the company form, but with some special features to ensure they are working for the benefit of the community.

Numerous 'Community Interest Companies' have been registered since part two of the Companies (Audit, Investigations and Community Enterprise) Act 2004 was passed and the Community Interest Company Regulations 2005 came into force on 1st July 2005. The hundredth Community Interest Company – 'Social Enterprise London' was registered on 27th January 2006 and by March 2007 a total of 845 Community Interest Companies had been registered in Great Britain. Of these, 694 were new registrations and 151 were conversions of existing companies. In April 2007 it also became possible to register a Community Interest Company in Northern Ireland.

Community Interest Companies are commercial companies that operate for the good of society in general or a specific section of the community. Any surpluses are used for the benefit of that community rather than the directors or shareholders. They can be a company limited by guarantee or shares or a public limited company. In practice most are companies limited by guarantee – 603 of the total of 845 in March 2007.

A Community Interest Company is seen as a suitable form of organisation for a Social Enterprise. A Social Enterprise is 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 maximise profit for shareholders and owners. Social enterprises tackle a wide range of social and environmental issues and operate in all parts of the economy. By using business solutions to achieve public good, the Government believes that social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy.

Currently companies that do not have charitable status find it difficult to ensure that their assets are dedicated to public benefit. There is no simple, clear way of locking assets to a public benefit purpose other than applying for charitable status. The Community Interest Company will help to meet the need for a transparent, flexible model, clearly defined and easily recognised.

Community Interest Companies operate in many market sectors, the main ones at March 2007 being: Social and Personal Services (291); Real Estate, Renting and Business (174); Education (170); and Health & Social Work (126).

Community Interest Companies are organisations pursuing social objectives, such as environmental improvement, community transport or fair trade. Social enterprises are playing an increasing role in regenerating disadvantaged areas, empowering local communities and delivering new, innovative services at local level.

A survey of Community Interest Companies carried out by the regulator in 2006 showed that 48% of them had been established to demonstrate community benefit and 15% had been established because the structure was suitable. 52% of Community Interest Companies felt that their status presented them with an opportunity to access increased funding.

Community Interest Companies are seen as a way of unlocking entrepreneurial potential and directing it towards social and community goals. A Community Interest Company enjoys the freedoms and flexibilities of a private company but has to demonstrate a real commitment to social goals. The test will not be how many Community Interest Companies register, but how many are still trading in the future. To date almost all the Community Interest Companies that have been established are still trading.

The sort of organisations that will want to set up a Community Interest Company will typically be entrepreneurs who want to do good in a form other than charity. This may be because:

- 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 of not-for-profit distribution status.
- 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 social enterprise 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 will apply to Community Interest Companies will be wider than the public interest test for charity.
- Community Interest Companies will be specifically identified with social enterprise. Some organisations may feel that consequently this is a more suitable than charitable status.

The Companies (Audit, Investigation and Company Enterprise) Act 2005 and Community Interest Companies Regulations 2005 apply to England, Wales and Scotland. The only difference being that, for the moment, a Scottish charitable company may not become a Community Interest Company.

Regulation and Registration of Community Interest Companies

There is an 'Office of the Regulator of Community Interest Companies' based in Companies House and requirements for Community Interest Companies in addition to the general company law. These include a need to file an annual community interest company report along with the usual accounts. This will be on public record and will describe how the Community Interest Company has met its objectives. The Regulator has three main functions:

- To decide whether an organisation is eligible to become, or continue to be, a community interest company;
- The investigation of complaints; and
- Enforcement action, if necessary.

Registering a Community Interest Company is similar to registering any other company with the Registrar of Companies. One difference is the need to apply to the regulator for confirmation that the company is eligible for Community Interest Company status. A Community Interest Company's Memorandum and Articles of Association also needs to contain specific provisions provided for by prescribed regulations.

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The application to Companies House needs to be accompanied by a "Community Interest Statement" in a form prescribed by the regulator and signed by the first directors. Community Interest Companies need to use the initials "CIC", or the words "Community Interest Company" in their title, although in the case of Public Limited Companies it reads "Community Interest Public Limited Company" or "Community Interest PLC".

The Community Interest Companies regulator will consider whether applications meet the criteria to become a Community Interest Company. If satisfied, the regulator will advise the registrar in Companies House who, providing all the documents are in order, will issue a certificate of incorporation as a Community Interest Company.

Community Interest Companies operate within an 'asset lock' whereby assets of the company must be retained and used for community purposes consistent with the company's objectives or transferred to another asset locked organisation such as a Community Interest Company or charity. The transfer of any assets from a Community Interest Company must otherwise be at market value.

Each year Community Interest Companies are required to produce an annual Community Interest Report as well as the annual accounts which are delivered to Companies House.

The Community Interest report needs to include details of the remuneration of the directors, the dividends paid on shares and the interest paid on capped loans. It also needs to explain what the Community Interest Company has done to benefit the community and how it has involved its shareholders in its activities.

Anyone wishing to form a Community Interest Company or to convert an existing company into a Community Interest company can download application forms from www.companieshouse.gov.uk or www.cicregulator.gov.uk.

Social Enterprises and Community Interest Companies

Social enterprises are diverse. They include local community enterprises, social firms, mutual organisations such as co-operatives, and large-scale organisations operating nationally or internationally. There is no single legal model for social enterprise. They include companies limited by guarantee, industrial and provident societies, and companies limited by shares; some organisations are unincorporated and others are registered charities.

Social enterprises tackle a wide range of social and environmental issues and operate in all parts of the economy. By using business solutions to achieve public good, the Government believes that social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy.

Social enterprises are an exciting and fast-growing sector. Yet some of the legal forms were originally designed for completely different types of organisation. The Government wanted to support the sector by creating a modern and appropriate legal vehicle and to help raise their profile. Hence the creation of Community Interest Companies.

The Community Interest Company 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.

Charities and Community Interest Companies

An organisation that is a Community Interest Company cannot also be a charity. Community Interest Companies are less regulated than charities. Even if a Community Interest Company has charitable objects it will still not be a charity.

A charity can convert to a Community Interest Company with the consent of the Charity Commissioners. In so doing it will lose its charitable status including tax advantages. A charity may however own a Community Interest Company in which case the Community Interest Company would be permitted to pass assets to the charity. In the same time an organisation must choose whether it wishes to incorporate as a Community Interest Company or a charity. Community Interest Companies will be more lightly regulated than charities but will not have the benefit of charitable status, even if their objects are entirely charitable in nature.

An organisation must choose whether it wishes to incorporate as a Community Interest Company or a charity. Community Interest Companies will be more lightly regulated than charities but will not have the benefit of charitable status, even if their objects are entirely charitable in nature.

Charities must be established exclusively for charitable purposes, but a Community Interest Company can be established for any lawful purpose, as long as their activities are carried on for the benefit of the community.

Charities have some tax advantages that Community Interest Companies do not have. In return for those advantages, charities are subject to more onerous regulation than Community Interest Companies.

Community Interest Companies will be free to operate more “commercially” than charities (e.g. Community Interest Companies limited by shares can pay dividends to individual shareholders, subject to a cap), but stakeholders in Community Interest Companies will still have the assurance of community benefit provided by the asset lock and transparency about their activities ability through the community interest report.

A charity can have a subsidiary which is a community interest company and the Community Interest Company would be permitted to pass its assets to the charity. This for example enables a Community Interest Company to run a charity shop and pass all the profits to the charity that owns it.

Charitable status is exactly right for many who wish to further charitable objectives and it is likely that most organisations operating for the public benefit (and who are eligible for charity status) will choose to be charities, not least for the fiscal advantages.

Although it will be technically possible to convert from Community Interest Company to charitable status and vice versa, it is not thought there will be much demand for this.

A Community Interest Company that became a charity would no longer be subject to the community interest test and the regulator. Instead it would be subject to the more restrictive provisions for charities and the Charity Commission. Similarly, a charity that converts to Community Interest Company status would need to satisfy the regulator that it was working in the community interest but it would lose the tax breaks.

An existing charitable company that wished to convert to a Community Interest Company would be subject to the same sort of controls as apply at present when a charitable company seeks to use the powers in the Companies Act 1985 to convert to a non-charitable company. A Community Interest Company that wished to convert to a charitable company would, of course, have to have exclusively charitable purposes.

Scottish charitable companies are subject to the constraints of Scottish charity law and Northern Ireland charitable companies to Northern Irish charity law.

The conversion process would not interrupt the corporate personality of the companies concerned. The bodies throughout would remain subject to company law but after conversion would cease to be subject to charity law and regulation but become subject to the Community Interest Company regulatory regime.

The resolutions have effect only when the Registrar of Companies registers them on the authorisation of the Regulator. The Registrar will also issue a revised certificate of incorporation.

A Community Interest Company cannot be a charity once the conversion takes effect and the company would be removed from the register of charities. The removal has effect from the date on which the Registrar of Companies registers the conversion resolutions. The directors of the company are required to notify the Commission of the constitutional change.

Converting a charitable company to a Community Interest Company brings new constraints and obligations and a change in the regulatory regime. It is recommended that a charity consults the Charity Commission and/or takes professional legal or accountancy advice on whether a Community Interest Company is the best way to run the organisation before proceeding with the conversion of the charitable company.

On conversion, the existing corporate property of the charity, other than its corporate capital, becomes impressed with a trust for charitable purposes in the same way as when a charitable company ceases, by some other form of constitutional change, to be a charity.

The company would, 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.

A community interest company must be a limited company. Therefore an unincorporated charity (including charitable trusts) cannot convert to a community interest company. However, the community interest company could be appointed as a corporate trustee of the charitable assets belonging to the unincorporated charity (or charitable trust) and could then apply the charitable assets for the furtherance of the charity's objects.

If the community interest company was incorporated, with the same charitable objects as the unincorporated charity or trust, the assets could be transferred to the community interest company for the furtherance of its objects, although the tax concessions from which the charity benefited would be lost.

If the unincorporated charity, or trust's assets, were depleted to a point where there were no assets remaining it could be wound-up. The option to wind-up would not apply to an unincorporated charity, or trust, that held a permanent endowment i.e. an asset, including land and investments, which must, under a legal document, be held permanently by the unincorporated charity.

Industrial Provident Societies and Community Interest Companies

Community Interest Companies will not replace Industrial and Provident Societies. The tradition is very strong in some sectors and some areas of the country. It can offer democratic accountability through Industrial and Provident Society membership structures. The Government is extremely supportive of the co-operative sector and recognises the importance of the Industrial and Provident Society as a legal form. That is why it supported a recently enacted Private Member's Bill which will help bring Industrial and Provident Society legislation up to date.

To convert to a Community Interest Company the Industrial and Provident Society must pass the necessary resolution and deliver them to the Financial Services Authority (for companies registered in England, Wales and Scotland) or the Registrar of Companies for Northern Ireland. The Society must also deliver, in respect of the application to form as a Community Interest Company, the following documents to the Registrar of Companies.

- Form Community Interest Company 36 (a community interest statement),
- Form 10 (name and particulars of first director(s) and secretaries & Registered Office) or Form 21 in Northern Ireland,

- Form 12 (statutory declaration of compliance with requirements of CA 1985) or the Form 23 in Northern Ireland, and
- Memorandum & Articles (as altered to comply with community interest company legislation)

The Registrar of Companies will pass these documents to the Regulator of Community Interest Companies to consider whether the society is eligible to form as a Community Interest Company. If eligible and if the documents are acceptable to the Registrar of Companies the documents are placed on the public record and a certificate of incorporation issued.

The Community Interest Test

Community interest is the heart of the Community Interest Company and the community interest test is what differentiates Community Interest Companies from other not-for-profit organisations. Demonstrating community interest is of value to those seeking grant funding or philanthropic investment.

The test is intended to be light touch. To become a Community Interest Company, an organisation needs to satisfy the regulator that its purposes could be regarded by a reasonable person as being in the community or wider public interest. It is also asked to confirm that access to the benefits it provides will not be confined to an unduly restricted group.

Political parties are not able to become Community Interest Companies, or to set up Community Interest Company subsidiaries. Organisations whose purposes are to organise support for a political party, or political campaigning are also unable to become Community Interest Companies.

Each application to become an Community Interest Company is studied and assessed on its own merits. However, to be eligible to be a Community Interest Company, an organisation must pass the 'Community Interest Test'. This means that the Regulator must be satisfied that a reasonable person might consider that the activities of that organisation will be carried on for the benefit of the community. To enable the Regulator to make this decision, all applicants for Community Interest Company status must make a Community Interest Statement, indicating why they believe that they satisfy the test. In addition, the constitution (memorandum and articles of association) of a Community Interest Company must comply with the relevant legislation.

Financial Implications for Community Interest Companies

Community Interest Companies do not enjoy any special tax status as such. They are generally in the same position as any other organisation in obtaining any tax concessions or grants otherwise available, for example due to their type of activity or location. A charity that becomes a Community Interest Company will lose its charity tax status.

Community Interest Companies can issue shares to raise investment. Community Interest Companies limited by shares have the option of issuing shares that pay a dividend to investors. To protect the asset lock, the dividend on these shares is subject to a cap set by the Secretary of State.

Like other social enterprises, Community Interest Companies find funds from a variety of sources, including grants and donations, loans from high street banks and other institutions. Only limited access to equity finance is permitted.

The Government is supporting finance for social enterprises, through community development finance institutions and the Community Investment Tax Relief. As the concept of social enterprise becomes more widely understood by the finance community, social entrepreneurs should find it easier to explain what they are doing and to get a competitive price for finance.

The Government is supporting social enterprises through the tax system. The Community Investment Tax Relief (CITR) gives tax benefits to investors who back businesses in less advantaged areas through Community Development Finance Institutions (CDFIs).

Community Investment Tax Relief provides tax relief of 5% per annum to investors who invest in an accredited Community Development Finance Institution, which then in turn lends to or invests in a qualifying profit-distributing enterprise or community project. Accredited Community Development Finance Institutions may invest in qualifying Community Interest Companies.

Community Interest Companies are eligible for the same tax relief available to other companies.

The Asset Lock

The Asset Lock is a fundamental feature of Community Interest Companies. It is important that the concept is understood before setting up a Community Interest Company as it has permanent long-term consequences.

‘Asset Lock’ is a general term used to cover all the provisions designed to ensure that the assets of the Community Interest Company (including any profits or other surpluses generated by its activities) are used for the benefit of the community.

The transfer must satisfy certain requirements. This means that, subject to the Community Interest Company meeting its obligations, its assets must either be retained within the Community Interest Company to be used for the community purposes for which it was formed, or, if they are transferred out of the Community Interest Company, the transfer must satisfy one of the following requirements:

- It is made for full consideration (i.e. at market value), so that the Community Interest Company retains the value of the assets transferred;
- It is made to another asset locked body (a Community Interest Company or charity, or non-GB based equivalent) which is specified in the Community Interest Company's memorandum or articles of association;
- It is made to another asset locked body with the consent of the Regulator; or
- It is otherwise made for the benefit of the community.

Provision to this effect, as prescribed in the Regulations, must be included in a Community Interest Company's memorandum or articles of association. Community Interest Companies are permitted to adopt asset lock rules that impose more stringent requirements, provided they also include these basic provisions.

The asset lock is established in legislation, and prohibits Community Interest Companies from distributing their assets or profits to their members, except to the extent permitted where Community Interest Companies issue equity. The lock does not prevent Community Interest Companies from using their assets efficiently in pursuit of community benefit. For instance, they are able to use assets as collateral for finance. The regulator is responsible for ensuring that the asset lock is maintained, and stakeholders who believe that it is being breached are able to ask the regulator to take action.

Equity Finance

The legislation is structured to allow Community Interest Companies to issue suitably capped investor shares, while recognising that demand for such shares may initially be limited. The level of demand is influenced by the way in which the cap is set. The Government has set the cap at a level that allows Community Interest Companies to access investment, without undermining their focus on community benefit.

The Government set the restriction on distributions and interest in part 6 of the Community Interest Company Regulations 2005, and the Community Interest Company regulator is responsible for setting the cap in a way that will balance need to encourage investment with the primacy of community interest. The Regulator takes the views of the social enterprise sector into account in setting the 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.

The government has not provided for 'real equity' because the concept of unrestricted distribution of dividends to shareholders is fundamentally contradictory to the concept of a company which is not-for-profit. This point was confirmed in the technical consultation where most of the respondents who favoured the ability of Community Interest Companies to issue shares and pay dividends, thought these should be capped in some way to protect the finance of the Community Interest Company, meet the statutory requirement for an asset lock and still attract some investors.

Those who want to use unrestricted equity can set up as normal companies, and Community Interest Companies can set up unrestricted subsidiaries e.g. to raise real equity for higher-risk ventures, provided the arrangement with the subsidiary is purely commercial.

The government believes that a balance can be struck between the flexibility needed by Community Interest Companies to raise finance and the need to provide a meaningful asset lock. Although investors have the possibility of making a modest return, this is restricted to ensure that the main beneficiary of the Community Interest Company is the wider community. One of the aims of the Community Interest Company concept is to expand the access to finance available to community organisations, permitting them to offer a reasonable return to investors is key to achieving this.

The decision as to how much an individual director is paid will be a matter for each Community Interest Company to decide itself. The Government does not wish to hold back the development of the sector by setting artificial limits. Stakeholders will be able to go to the regulator if they consider remuneration levels are inconsistent with a Community Interest Company's community benefit aims. There will be some additional reporting requirements on directors' pay.

Regulation

Community Interest Companies report annually to the independent regulator on how they are delivering for the community and how they are involving their stakeholders in their activities.

Community Interest Company regulation is 'light-touch'. The majority of Community Interest Companies have a similar relationship with the Community Interest Company regulator as companies have with Companies House (i.e. registration followed by annual returns). The very active regulation which is necessary for charities is not be required for Community Interest Companies.

However, the regulator is able to investigate complaints from stakeholders and has powers to act if it is found that a Community Interest Company is not working in the interest of the community or that the profit/asset lock is not being observed. These powers include the ability to change the directors or wind up the company.

The Regulator is an independent public office holder appointed by the Secretary of State for Trade and Industry. The appointment was subject to an open public recruitment process monitored by the Office of the Commissioner for Public Appointments

The main duties of the regulator are to:

- Consider applications to form a Community Interest Company;
- Ensure that a Community Interest Company complies with its legal obligations;
- Take enforcement action where serious infringements occur.

The Regulator also has an important role in:

- Development of Community Interest Companies as a new company type
- Providing help and guidance to Community Interest Companies, to those people considering setting up a Community Interest Company, and to business professionals advising Community Interest Companies.

Community Interest Companies are encouraged to involve their stakeholders as a matter of best practice and will be required to report to the regulator on how they have done so.

In the same way as a private company or a charity, each Community Interest Company will be controlled by those individuals who are appointed to its board and by those who become shareholders/members. The precise structure that is put in place is a matter for each Community Interest Company to determine and reflects the particular needs that apply in specific cases.

Community interest companies are limited companies subject to general company law, like other companies registered under the Companies Act 1985. A private company limited by shares or guarantee must have one member and any other company must have at least two members. There is no maximum number of members. The members of a company are the subscribers to the company's memorandum (who are deemed to have agreed to become members) and all other persons who have agreed to become members of the company. In a company limited by shares, members purchase shares, with their liability being limited to any amount owing to the company in respect of their shares. In a company limited by guarantee, members agree to be liable to contribute a specified amount in the event of the company being wound up.

Every private company must have at least one director. Every other company must have at least two directors. Where a company has only one director that person cannot also be the company secretary, or a corporation whose sole director is a company secretary.

Comments on Community Interest Companies

In his annual report for 2006/07, John Hanlon, the Regulator of Community Interest Companies, said:

“The statutory asset lock, I believe, should be an important consideration when both central and local government are awarding contracts, or providing start-up finance and other assistance in the communities they serve.

“The Community Interest Company asset lock ensures that the assets, and any surpluses the Community Interest Company generate, is applied to benefit the community, not to generate funds for personal profit. As far as other bodies are concerned, the asset lock should provide reassurance to them also.

“The concept of a Community Interest Company, which is incorporated as a private company limited by shares, is one which has challenged a number of funders. I am pleased to say that once the central features of such a Community Interest Company are explained i.e. capital appreciation on shares, and a dividend which has a cap to ensure the lion's share of any profits goes to benefit the community, grant funders have become increasingly supportive of Community Interest Companies, and are providing start-up funds.

“As more and more people become aware of the Community Interest Company form, and the flexibility it can offer, as they work to benefit the communities they are passionate about, I am convinced that Community Interest Companies will continue to be a growing force for good in communities across the United Kingdom.

"I have said I do not see any no-go areas for Community Interest Companies. Successful Community Interest Companies will be a liberating force for people in this country and abroad. We will see Community Interest Companies lead the way in the provision of services to communities, by communities, for communities. As more people see what the Community Interest Company form can offer their communities, this good will grow.

"There is still a real buzz of excitement when we see applications which have the vision to change people's lives for the better and real enthusiasm among the staff for what Community Interest Companies can do for people and communities."

Rt. Hon. Alun Michael MP, Minister of State for Industry and the Regions, said:

"The Community Interest Company is an attractive legal vehicle for those operating social enterprises across the country. I am particularly delighted about the high proportion of new start-up businesses choosing this model. This demonstrates that the Community Interest Company structure is meeting the needs of new entrepreneurs looking to use their business for social good."

Conclusions

The Community Interest Company is a form of company that has been found popular and appropriate by organisations that wish to pursue community benefits without necessarily becoming a charity. Many organisations have become Community Interest Companies.

Adrian Waite
December 2007