

## Chapter 2: Preliminary considerations - Contents

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## 2.1. Considerations before choosing to form a CIC

A community interest company (CIC) is a legal form with the capacity to generate surpluses for re-investment in the community. As such it is a valuable additional model for those considering creating a social enterprise.

Setting up a CIC is a big step, not least because a CIC is only allowed to cease being a CIC by dissolution / liquidation or by converting to a charity. This means that once a company is a CIC it cannot become an ordinary company. The only “ways out” are:

- ❖ dissolving the company and ceasing to exist altogether, or
- ❖ converting the CIC to a charity and subjecting the company to the more onerous regulatory regime of charity law.

But if you are sure that the following key objectives apply to your organisation the CIC may well be the legal model for you. If you are in doubt about any of them think twice before taking steps towards forming, or converting, to a CIC. In any event consider the full list of major considerations below and bear them in mind before going any further and be sure to take professional advice where needed.

### 2.1.1. What are you trying to achieve?

- ❖ You want to incorporate (be a company) with limited liability.
- ❖ You want to be a company because it is a familiar legal form with the flexibility to tailor it to your own organisational structure, membership and governance.
- ❖ You want it to be clear to your members, financial backers, customers and others you deal with that you will work for the benefit of the community rather than private gain.
- ❖ You want to be sure that, if the organisation ceases to be a CIC, the remaining assets will be preserved for the community rather than distributed to members.
- ❖ You do not want charitable status e.g. because it is not appropriate to your planned activities or the financial benefits of being a charity will not be material.
- ❖ You want transparency of operation so that anyone affected by the companies activities can see, on the public record, an account of the benefit provided; how stakeholders were involved; and what assets were transferred and to whom.

### 2.1.2. Major considerations

- ❖ What activity do you want to undertake and how will it benefit the community?
- ❖ What community will benefit (see Chapter 2.3)? If the community is too narrowly defined, the company will not be eligible to be a CIC.
- ❖ Who will be the owners, managers, directors, shareholders or guarantors?
- ❖ How will it be funded?
- ❖ How will any surpluses or profits be used and what do you want to happen to any remaining assets if the CIC is dissolved?
- ❖ Will being a company with limited liability, legal identity and the benefits of continuity suit your needs?

### 2.1.3. Do you understand the permanent effect of the asset lock?

In most cases becoming a CIC will have long term consequences (see Chapter 6).

- ❖ Do you want to pay dividends to investors, and will the ability to pay dividends have a favourable or adverse effect on your funding or tax status? Do you understand the dividend cap limitations on the payment of dividends? If you do not want to pay dividends would a CIC limited by guarantee be the best option?
- ❖ Do you understand the continuing obligations of CICs such as filing of annual returns and accounts with a CIC annual report and will your organisation have the capacity to perform these (see Chapter 9)?
- ❖ If you are an existing unincorporated organisation, are the existing stakeholders, creditors, trustees etc in agreement with the change to a CIC and are you in a position to make any necessary transfer of assets?
- ❖ If you are (or want) to be a charity remember that the same organisation cannot be both a CIC and a charity (see CAICE Act 2004 s.26(3)). CICs will be more lightly regulated than charities but will not have the benefits of charitable status, even if their objects are entirely charitable in nature. Charities will be able to establish CICs as subsidiaries that can pass assets and profits to their charity owners without asset lock restrictions.
- ❖ Being a CIC will not confer any special tax status as such. CICs will generally be in the same position as any other organisation in obtaining any tax concessions otherwise available, for example due to their type of activity or location. You should make sure you understand the tax consequences for your

organisation of becoming a CIC. This is particularly so for organisations with wholly charitable purposes where the benefits of lighter CIC regulation may be outweighed by the tax benefits of being a charity. If in doubt get professional advice.

- ❖ Being a CIC will not confer any automatic right to grants or other special funding although the nature of your activities or location may do so.
- ❖ Transparency is an important aspect of CICs. Stakeholders should get a clear idea of how a CIC has performed. It will make an annual community interest company report detailing what it has done and how this has benefited the community; what directors' salaries and dividends have been paid; and to what extent it has involved its community in its activities. You will need to consider from the outset how you will involve the stakeholders in the project.
- ❖ If you think it likely that you will want to offer shares to the public, you should set up as a CIC PLC (although of course it is perfectly possible to "re-register" a private company as a public company)

The decision whether the CIC form is suitable for your organisation must be a matter for you and your professional advisers.

#### **2.1.4. Useful websites**

[www.businesslink.gov.uk](http://www.businesslink.gov.uk), which has practical advice for businesses and guidance on choosing the right legal structure for your community activity;

[www.acevo.org.uk/legalforms](http://www.acevo.org.uk/legalforms), which contains a decision tree on legal forms of organisations;

[http://www.sbs.gov.uk/SBS\\_Gov\\_files/socialenterprise/LegalTable.pdf](http://www.sbs.gov.uk/SBS_Gov_files/socialenterprise/LegalTable.pdf) provides a rough guide to legal structures most commonly associated with social enterprises.

## **2.2. Who can form a community interest company (CIC)**

In general any organisation, or individual, that has formed or intends to form a company and is prepared to accept the special features and restrictions can form or convert to a CIC, subject to meeting the community interest test (see Chapter 4).

### **2.2.1. Restrictions on forming as a community interest company**

- ❖ A charitable company cannot be CIC it would have to give up its charitable status.
- ❖ Companies that engage in activities which a reasonable person might consider only benefit the members of a particular body or the employees of a particular employer will not satisfy this test.
- ❖ Political parties and pressure groups, or companies owned or controlled by them, cannot become CICs (see Chapter 2.7. and 4, section 35 of the Act and Part 2 of the Regulations).
- ❖ A Charitable company registered in Scotland or Northern Ireland cannot apply for CIC status (giving up its charitable status in the process) until the necessary legislation comes into force.

A CIC must be a limited company. It can either be incorporated as a company or an existing company can be converted to a CIC (see Chapters 3 and 4). However, all CICs share certain special features and are subject to certain restrictions (these are dealt with throughout these notes but see particularly the overview in Chapter 1).

If an existing organisation, which is not a limited company, wishes to convert to a CIC it will have to become a company first. In many cases a more practical course may be to form a new CIC to which it can transfer its assets and liabilities.

Some organisations may find it impracticable (for example, because of the financial implications of losing charitable status if they are charities), or legally impossible (for example, because of insuperable barriers in their existing constitutional arrangements) to become a CIC. These are important issues and will almost certainly require detailed professional advice.

### 2.3. Defining “community” in community interest company

The essential feature of a CIC is that its activities are carried on for the benefit of the community and it is therefore important that before creating a CIC you have a clear picture of the community you intend to serve.

A community for CIC purposes can embrace either the community or population as a whole or a definable sector or group of people either in the UK or elsewhere. The Act provides that for the purposes of the community interest test, “community” includes a section of the community. The Regulations state that any group of individuals may constitute a community if they share a common characteristic which distinguishes them from other members of the community and a reasonable person might consider that they constitute a section of the community (Regulation 5, as amended by the Community Interest Company (Amendment) Regulations 2009).

However, a company which benefits a group which may be clearly defined, but which a reasonable person might not consider to be a genuine section of the community (e.g. “my family”, “my friends”, or “regular drinkers of ABC beer”), is unlikely to be eligible to be a CIC. In other words, in the Regulator’s view, regulation 5 has to be against the overall background of the view which a reasonable person would take of what constituted a section of the community for the purposes of the community interest test.

It is therefore expected that the community will usually be wider than just the members of the CIC. For example, the community of a CIC formed to run a community bus service would include the whole of the population of the area served not just those residents who had invested in the company.

In most cases the community should be easy to define such as:

The residents of Oldtown  
People with learning difficulties  
Older People  
The young unemployed  
Small scale produce growers in Africa  
The XYZ charity  
People who have ABC disease  
People wishing to learn to...  
Youth of Oldtown needing sports facilities  
Redundant car workers

In other cases the purpose of the CIC will in itself suggest a benefit to the whole community such as:

- Research into environmental pollution
- Preservation of wetlands
- Provision of advice services
- Preservation of language/culture
- Encouragement of sport
- Establishing a museum
- Hire of equipment for short term needs
- Support for community projects

In further examples the community may be the beneficiary of surpluses or profits of trading activities which may not themselves be specifically community benefit activities. Such CICs could have purposes described in terms such as:

- Trading to create a surplus to assist...
- Contracting to provide services and using surpluses from this for the benefit of...

This type of activity where the community benefit may be either from the activity itself or the profits of the activity (or both) are areas where the CIC format could be particularly suitable. CICs could for example act as the procurement arm for a group of schools or care centres who in turn could benefit by participation in dividends as shareholders or donations from profits if they were themselves asset locked bodies.

A CIC must not be too deeply involved in any form of political activity (see Chapter 2).

You should note that a company can only be eligible to become a CIC if it satisfies the community interest test. A company will not be eligible if any of its activities benefit only the members of a particular body or the employees of a particular employer, without bringing any benefits (directly or indirectly) to a wider community.

If the community which your proposed CIC is primarily intended to serve is made up of members of a particular body or employees of a particular employer, you will need to think carefully about this and consider what wider community benefits the proposed CIC can be said to deliver (see Chapter 4).

## **2.4 Charities converting to CIC status or vice versa**

### **2.4.1. Conversion of a charity to a CIC in GB (see chapter 4)**

The Companies (Audit, Investigations and Community Enterprise) Act 2004 specifically excludes the same body from being both a CIC and a Charity (see CAICE Act 2004 s.26 (3)). It is possible for a CIC to have wholly charitable purposes, but such a CIC will not be entitled to charitable status.

A charitable company registered in England, Wales or Scotland may convert to a CIC with the consent of the Charity Commission. In so doing it will lose its charitable status, including tax advantages (See Chapter 4 for more detail and CAICE Act 2004 s.39).

### **2.4.2. Conversion of a charity in Northern Ireland to a CIC**

Whereas the Act provides for a charitable company registered in England, Wales or Scotland to convert to a CIC, (see Chapter 4) it prohibits such conversion of a Northern Ireland charity. It is expected that regulations will be considered at a later date to provide for the conversion of a Northern Ireland charitable company to a CIC.

### **2.4.3. CIC converting to a charity (see chapter 10)**

A CIC may convert to a charity registered in England, Wales, Scotland or Northern Ireland in which case it would cease to be a CIC. It would then be fully subject to the charity regulatory regime (see Chapter 10 for more detail).

### **2.4.4. A CIC may have wholly charitable purposes**

On the other hand a CIC may have wholly charitable purposes and be entitled to charitable status, but may not want to be subject to the regulatory requirements associated with being a charity regulated by the Charity Commission, or to be subject to the charity jurisdiction of the High Court.

### **2.4.5. A CIC may pass its assets and profits to a charity**

A CIC may pass its assets and profits to a charity as they are both asset-locked bodies [See Chapter 6] and may nominate a charity to receive its surplus assets if the CIC is liquidated or dissolved [See Chapter 10].

### **2.4.6. Some points to consider**

If you are considering converting from a charity to a CIC, or *vice versa*, you should consider carefully the advantages of doing so. Some of the points you will need to consider include:

- ❖ Tax implications
- ❖ The attitude of funding bodies
- ❖ The flexibility of the respective regulatory regimes
- ❖ Management and employment structures
- ❖ Whether the community interest test for CICs is more appropriate to your purposes than the public benefit test applied to charities
- ❖ Whether the ability of CICs to pay directors and (in some cases) dividends would help you to attract the right management and investment
- ❖ The fact that at the point of conversion the CIC will be under a duty to apply for the registration of a charitable trust to manage the charitable company's property (other than property representing subscribed capital, in the case of a company limited by shares). This means that the charitable property before conversion cannot be transferred to the CIC: it must be held by a charitable trust. The trust is subject to regulatory action under section 18 Charities Act 1993 in just the same way as any other charity would be.
- ❖ Which type of CIC is appropriate for your purpose i.e. private limited by shares or guarantee or a public limited company [See Chapter 3].

## 2.5. Charities considering setting up a CIC subsidiary company

A charity may set up a CIC subsidiary company. This, for example, enables a CIC to run a charity shop and pass some or all of the profits to the charity that owns it; or for several charities to jointly own a CIC to provide them with support services.

If you are a charity and considering setting up a CIC subsidiary company you should consider the following advice from the Charity Commission ([www.charity-commission.gov.uk/publications/cc35.asp](http://www.charity-commission.gov.uk/publications/cc35.asp) "Trading by subsidiary companies"):

- ❖ The financial structures of the charity and the subsidiary trading company ought to be kept separate.
- ❖ The separate identities of the charity and the subsidiary trading company should be made clear in all publicity material and, in dealings with suppliers.
- ❖ The names of the charity and the subsidiary trading company should be distinguished from each other to prevent confusion between the activities of the two organisations.
- ❖ The charity must not settle the debts of the subsidiary trading company.
- ❖ The charity should not feel any moral obligation to fund the subsidiary trading company.
- ❖ Any financial support the charity can give to the subsidiary trading company including non-cash commitments (eg staff, office space and equipment) should be carefully assessed.
- ❖ The charity buying stock and donating it to the subsidiary trading company should be avoided.
- ❖ Plan for the subsidiary trading company to be financially viable as soon as possible. Normally, this will be within its first 5 years of operation.
- ❖ The need to obtain the Commission's authority to any proposal for a lease of property by a charity to a subsidiary trading company.
- ❖ To ensure that investment in a subsidiary trading company is a qualifying investment for tax purposes.
- ❖ To ensure that at least one person who is a trustee of the charity is not a director of the trading company, and at least one person who is a director of

the trading company is not a trustee of the charity. Those without dual interests can be expected to give suitable advice in a conflict of interest situation. This should reduce the risk of transactions between the charity and the company being challenged, or questioned.

- ❖ A charity trustee cannot be paid for his services as a director, or employee, of the subsidiary trading company (or, of course, as an employee or trustee of the charity) unless the governing document of the charity specifically provides for this.

In addition to the above, the trustees must be aware of what rights ownership of shares in the subsidiary trading company will give to the charity (or themselves). Examples of such rights are:

- ❖ voting powers;
- ❖ appointment of directors;
- ❖ remuneration; and
- ❖ dividends.

These are all very serious factors, which you should consider carefully with your professional advisers before you decide which format to adopt.

The Regulator and the Charity Commission are aware that there may be advantages in organisations comprising part CICs and part charities and wish to avoid their respective regulatory responsibilities being seen as an impairment to such organisations. They are, therefore, working closely together to minimise any such difficulties.

## **2.6. Industrial and provident societies (IPS)**

Industrial and Provident Societies (IPS) are societies registered under the Industrial and Provident Societies Act 1965 and can take several forms such as co-operatives or community benefit societies.

Just as social enterprises can adopt a number of different company law forms, so they frequently adopt either the “co-operative” or “community benefit” types of industrial and provident society form. However, community benefit societies are more closely analogous to CICs, particularly when they impose on themselves a statutory asset lock of the kind provided for in the Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, made under the Co-operatives and Community Benefit Societies Act 2003.

### **2.6.1. IPS considering converting to a CIC (see chapter4)**

If an Industrial and Provident Society wishes to consider becoming a CIC please see the Chapter 4.

### **2.6.2. CIC converting to an IPS BenCom (see chapter10)**

If CIC wishes to consider converting to an Industrial and Provident Community Benefit Society see chapter 10.

### **2.6.3. Useful websites:**

- ❖ Financial Services Authority regulates Industrial and Provident Societies.
- ❖ Co-operatives <sup>UK</sup> the central membership organisation for co-operative enterprise throughout the UK.

## 2.7. Excluded companies and political activities

Excluded companies are companies (or prospective companies) that the Regulations prescribe as not being eligible to be formed as or converted to CICs (see CAICE Act 2004 s.35.).

The only companies that are at present so prescribed are:

- ❖ A political party
- ❖ A political campaigning organisation
- ❖ A subsidiary of a political party or political campaigning organisation.

The Regulations also provide that for the purposes of the community interest test (see Chapter 4) a wide range of political activities are to be regarded as not being carried on for the benefit of the community. There is a considerable amount of overlap between the definitions of “excluded companies” and the description of these activities. Companies engaging in these activities are not eligible to become CICs and any CIC engaging in such activities could cease to satisfy the community interest test and be subject to enforcement action by the Regulator.

These activities are:

- ❖ The promotion of (or opposition to) changes in the law or changes in the policy of any governmental or public authority in relation to any matter
- ❖ The promotion of (or opposition to) any proposed policy of a governmental or public authority in relation to any matter
- ❖ Activities which provide or affect financial or other support to a political party or campaigning organisation
- ❖ Activities intended or likely to influence voters in relation to an election or referendum

Examples of the kinds of activities that could fall within these headings include trying to improve the quality of life for the people of a particular country:

- ❖ which is suffering as a result of national or international political, military or economic action by persuading those responsible to cease or modify that action, or by trying to influence public opinion about an activity which is currently illegal with a view to bringing about a change in the law.

The reason for this wide-ranging exclusion of political activities is that Parliament did not want to put the Regulator in the position of having to decide whether particular political programmes are, or are not, beneficial to the community. Such a decision would otherwise be implicit in the application of the community interest test to companies with a significant political agenda. Inevitably, this means that some companies whose aims might appear to reasonable people to be entirely laudable and (in the ordinary sense of the words) beneficial to a particular section of the community, are barred from becoming CICs because their activities have an intrinsically political character.

However the legislation recognises that there are times when a company's non-political aims and activities necessarily involve it in some form of political action or debate, without compromising its fundamentally non-political nature. Therefore, a CIC may engage in prescribed political activities if its engagement in them can reasonably be considered as incidental to activities which a reasonable person might consider are carried on for the benefit of the community, and which are not themselves incidental to political activities. For example, a CIC that uses a community centre for activities, which benefit local people, may be able to lobby local government for a grant to improve the facilities available in the building.

Inevitably, deciding when political activities fall within this "incidental" exception calls for the exercise of judgment. The Regulator will take into account all the available evidence, including the track record of an organisation and its members, the views of its members and the community they represent, and the likely political consequences of their activities.

## THE BASIC PRINCIPLES

The basic principles are:

1. That CICs should not be formed for political purposes, or have engagement in political activities among their main objectives; and
2. That any political activities in which CICs do engage should be closely related to the non-political community benefit activities which they are set up to carry out.

The terms used in this Chapter are given very broad meanings in the Act and Regulations. If you feel that there is any chance that your activities, or proposed activities, may fall within the prescribed activities you should take early professional advice or contact the Office of the Regulator before taking any decisive steps toward forming or becoming a CIC.

## 2.8. Community interest company names

Before choosing the name of your proposed CIC you should consult the Companies House booklet "Incorporation and Names", which outlines the name provisions which apply to all companies. In particular it lists names that may not be used without the prior approval of the Secretary of State or other relevant bodies [See [www.companieshouse.gov.uk](http://www.companieshouse.gov.uk)].

Companies (Audit, Investigations and Community Enterprise) Act 2004 requires that a CIC must have a name ending with one of the prescribed designations. Companies that are not CICs must not use these designations and there are criminal penalties for misuse of these designations (see CAICE Act 2004 s.33 and Schedule 6]

The designations are:

### **Public Companies**

community interest public limited company or community interest p.l.c.

### **Other companies**

community interest company or c.i.c.

### **Welsh Companies**

A company whose application for registration states that its registered office is to be situated in Wales may use Welsh alternatives which are:

### **Public Companies**

cwmni buddiant cymunedol cyhoeddus cyfyngedig or cwmni buddiant cymunedol  
c. c. c.

### **Other companies**

Cwmni buddiant cymunedol or c.b.c.

NB To use the Welsh designations your company's application for registration must provide that its registered office is to be in Wales (and it must in fact be there): it is not enough to simply operate in Wales; but having your registered office in Wales does not restrict you from operating elsewhere.