

REPORT ON CORPORATE STRUCTURES FOR LOCAL HEALTH WATCHES

1. PURPOSE OF REPORT SUMMARY

Local health watches will be required by legislation to be a corporate body. They may choose between a wide variety of structures each which has its advantages and disadvantages. It appears to us rightly that the most suitable format will be charitable company limited by guarantee. If Charitable Incorporated Organisations – (CIOs) come into existence at sometime they may be a contender and both Community Interest Companies (CICs) and Industrial and Provident Societies (IPSs) - Community Benefit Societies and not-for-profit companies limited by guarantee are alternative possibilities.

2. COMPARISONS

	Charitable Company	CIO	CIC	IPS	Not for Profit
Charity	Yes	Yes	No	Possible	No
Registered with the Charity Commission	Yes	Yes	No	(1) No	No
Exclusively Charitable purposes	Yes	Yes	No	Possible	No
Limited liability	Yes	Yes	Yes (2)	Yes	Yes
Tax exemptions, rate relief and Gift Aid available	Yes	Yes	No	Possible	No
Regulator	CC CH	CC	CICR	FSA	CC
Familiar structure	Yes	No	No	No	No
Payment of Directors/Trustees	For services only	?	Possible	No	Possible
Investment by members possible	No	No	Yes (3)	Yes (4)	No
Asset Lock	Yes	Yes	Yes	No	No
Available now	Yes	Awaited	Yes	Yes	Yes

CC = Charity Commission
CICR = CIC Regulator

CH = Companies House

FSA = Financial Services Authority

(1) An IPS will be registered with the Commission from late 2011

(2) A CIC can be a company limited by shares or by guarantee

(3) For CICs that are limited by shares

(4) The current maximum investment by a member is £20,000, unlimited for other IPSs.

3. CHARITABLE COMPANY LIMITED BY GUARANTEE

3.1 Regulation and Structure

A company limited by guarantee is the structure that is often used by not-for-profit organisations. This kind of company does not have share capital and rather than shareholders it has a number of members who each guarantee that they will contribute (usually £1) towards any debts of the company. Since a company limited by guarantee has no share capital its capital must be obtained from loans, grants and retained profits.

This type of company is a separate legal entity with limited liability that registers with and is regulated by the Registrar of Companies, (also known as Companies House) to which

annual returns and accounts must be submitted, and the details of directors' appointments and resignations and mortgages and debentures must be filed. It is governed primarily by the Companies Acts 1985 to 2006.

A company is governed by its Memorandum and Articles of Association. This governing document states what the charitable objects of the Company are, what the Company has the power to do, what will happen to any surplus assets, what will happen to assets on dissolution, whether directors can be paid for their services, the nature of the membership, the appointment and removal of directors and how to hold meetings.

3.2 Charitable Status

In order for a company limited by guarantee to be charitable, its objects must be for the public benefit and exclusively charitable. Charities with an annual income of over £5,000 must register with the Charity Commission. Such companies are therefore dually regulated by both the Commission and Companies House.

Obligations a charitable company have towards the Charity Commission include filing accounts and annual returns (which will now include a section reporting on the public benefit a charity provides, and a Summary Information Return form detailing a charity's aims, objectives and achievements over the past year). The Charity Commission in addition has powers to visit charities in order to look at its activities, management and procedures. It also has the power to investigate trustees of its choice in case of misconduct or mismanagement.

A Charitable Company's governing document can be readily amended, and only a very limited number of such amendments must be approved by the Charity Commission. In addition a Charitable Company should have in place more policies and protocols, such as a reserves and a conflict of interest policy than a commercial company.

3.3 Members and Directors

Membership can be small or unlimited.

Members of a charitable company have the right to be invited to attend, speak and vote at general meetings of the company, and to make certain decisions such as the appointment and removal of directors and the approval of any changes to the governing document. Their liability is limited, usually to £1.

The directors of the Charitable Company are one and the same as the Charity Trustees. If for any reason a person should be removed as a director of the Company, for example were they to be made bankrupt, they would automatically also be removed as trustees of the charity. Directors are subject to duties as laid out in company legislation as well as the rules governing charity Trustees and a Charitable Company director must act in a way he considers, in good faith, would be most likely to achieve the purposes of the company.

3.4 Advantages of Charitable Companies

- Unlike trusts, the liability of both members and directors (and therefore Charity Trustees) is limited.
- The company format is familiar to and well understood.
- Significant reputational advantages can be gained through the trust and confidence the public has in registered charities.

- Certain bodies will grant funding to non-charities, but a large proportion of funders require charity registration as a prerequisite.
- Primary purpose trading activities are exempt from tax on profits provided that the profits are applied solely for the purposes of the charity.
- There are rules allowing a small amount of non-primary purpose trading and fundraising events within certain limits are allowed.
- The exemption from tax also applies to other trades which are not primary purpose trading but which are ancillary to it. Separate advice can be given on trading tax liability if required.
- Registered charities get a mandatory 80% rate relief on business rates, with some local authorities, in their discretion, giving the full 100%.

3.5 Disadvantages of Charitable Companies

- Charitable Companies are dually regulated by the Charity Commission and Companies House increasing administrative burdens as filings must be made twice.
- Trade beyond primary purpose trading and ancillary trading within certain limits is prohibited; however, you can use your trading subsidiaries for this purpose.
- No equity is provided by members. Members can however make loans to a Charitable Company.
- Directors (and therefore Charity Trustees) can not generally be paid for their role as directors. Despite this, it is possible to word the governing document to allow payment for services from Trustees.
- There are more regulations surrounding fundraising, agreements with commercial participators and professional fundraisers than for a non-charitable company however this is the case for all charities, whatever their legal structure.
- If the charity wishes to support local social enterprise organisations then it can do so only to support their charitable activities.

4. CHARITABLE INCORPORATED ORGANISATION

A Charitable Incorporation Organisations (CIOs) will have a legal structure that has been designed specifically with charities in mind. It will not be a company and will not be subject to company legislation. This legal structure is not yet available but may be available towards the end of 2011 or in 2012. However there is a risk implementation will be delayed indefinitely. As a result section 4 of this report is based on draft consultation papers only.

4.1 Structure and Regulation

A CIO will be governed by its Constitution, a shorter document than a more usual Memorandum and Articles of Association. Model Constitutions are likely to be available for both the foundation and association models (discussed further below), but it is likely that permitted amendments to the model will be quite restricted. Where a charitable company limited by guarantee converts to a CIO any guarantees provided by members which are £10 or less will be extinguished.

There will be an obligation on CIOs to hold general meetings (and the model Constitution provides for an AGM). However the majority of decisions can be made by written resolution if the Constitution allows.

4.2 Charitable Status

A CIO will be a registered charity.

4.3 Types of CIOs

The Constitution for a CIO can be a foundation or association model. A foundation model provides for the members of the charity to be restricted to the trustees of the charity. The association model provides more flexibility and for the membership to be broad.

4.3 Members and Trustees

In a CIO, members will not have the right to appoint a proxy unless this is provided for in the constitution. (It should be noted however that proxy voting is included in the model constitution).

In a traditional company structure, members have rights but no duties or responsibilities. In a CIO both members and trustees will have a statutory duty to act in a way that they believe in good faith will further the purposes of the CIO (it is not yet clear how this would be enforced for members).

Trustees must be at least 16 years old. Trustees will not also be company directors. Unlike in company structures, the members will not have the right to remove the trustees of a CIO. All trustees have a duty to act with reasonable care and skill in performing their duties. However, the CIO's Constitution might be able to provide for this duty not to apply to specified trustees or in certain circumstances. This provision has been controversial and it is not clear yet whether it will be implemented. If this is implemented, the Constitution must specify what level of care does apply, with the minimum being that a trustee must not act in a way which he or she knows is not in the best interests of the CIO, or does not care whether it is in the best interest of the CIO.

4.4 Advantages of a Charitable Incorporated Organisation

- A CIO is registered and regulated by the Charity Commission only, is only subject to charity legislation, and is required to submit only one set of returns and accounts to the Commission.
- Registration and filing information with the Commission will be free of charge

4.5 Disadvantages of a Charitable Incorporated Organisation

- This structure is still unavailable and as a result remains untested. It is also not yet well-known to the wider business community.
- It will be entirely serviced by the Charity Commission who are undergoing severe funding cuts.
- A CIOs constitution will be less flexible to suit a particular organisation than that of a charitable company.

5. COMMUNITY INTEREST COMPANY

Community Interest Companies (CIC) are limited liability companies that conduct business or other activities for the community benefit and not solely for private advantage. They can be limited by shares or limited by guarantee. They cannot serve an unduly restrictive group in the community and cannot be politically motivated.

In order for an existing company to convert to a CIC it must satisfy the 'Community Interest Test' by submitting a statement detailing what it will do, who it aims to help and how it will achieve this to the CIC Regulator. In addition it must pass resolutions to make changes to its name and its governing document and pay a nominal fee for registration.

5.1 Structure and Regulation

A CIC is incorporated and registered with Companies House and is subject to company legislation. It is regulated by the CIC Regulator, and must deliver to it its annual accounts and an annual community interest company report, both of which are for the public record. The report will include details of the benefits it has provided to the community, payments made to directors and dividends paid out (where relevant). The CIC Regulator may investigate the affairs of a CIC, require an audit of the company's accounts and order a transfer of specified shares in the company to specified persons (or, where the company is limited by guarantee, terminate membership).

There is a statutory requirement for all CICs to adopt certain clauses in its governing document, in particular requiring it to have an 'asset lock'. This provides the company shall not make any disposition, distribution, transfer or payment other than at market value, unless the assets are transferred to another asset locked organisation, or the CIC Regulator consents, or the assets are distributed under market value for the benefit of the community. In addition there must be a clause that prevents the company from falling in to the control of individuals or organisations that are not members of the company.

5.2 Types of CIC

A CIC can be limited by guarantee or by shares.

A CIC which is limited by shares can access debt markets for loans and bonds, sell shares, and, subject to certain procedures, can distribute some of its profits to its members.

5.3 Charitable Status

A CIC cannot be a charity. As a result it cannot take advantage of any tax exemptions or rate reliefs.

5.3 Members and Directors

A CIC which is limited by shares may, if agreed by the members, pay a dividend on certain shares but these will be subject to a 'dividend cap', setting a maximum dividend per share. Having such a dividend cap will exclude venture capitalists.

Directors have the same duties and responsibilities as for any other company. In addition they must ensure that the CIC is run in such a way that it will continue to satisfy the community interest test. Directors of CICs can be paid a reasonable remuneration, if permitted in the CIC's governing document, but any remuneration arrangements must be transparent and stated in the annual CIC report which is available to the public.

5.4 Advantages of Community Interest Companies

- Regulation is by one regulator only and is light touch.
- The community interest test will allow broader purposes than the public benefit requirements for a charitable organisation.
- Directors can be paid a reasonable remuneration if the governing document allows.
- The statutory asset lock provisions prevent assets from being distributed for less than market value unless for the community benefit. However this is no different to the provisions in place for charities.
- The dividend cap prevents all profits being paid to members and directors.
- There are no trustees and no trustee control of the company.

5.5 Disadvantages of Community Interest Companies

- The brand is less familiar and less well known to the business community and the general public than a charitable organisation.
- A CIC cannot be a charity. This will make a significant number of large funding streams (that require charity status and a registration number) unavailable. Private investors may not fill this gap in funding as the cap on dividends will be unattractive.
- Tax exemptions, rates relief and Gift Aid are not available for CICs, however a CIC could approach their local authority to seek some form of voluntary relief on business rates.
- A CIC is subject to the usual regulatory constraints and powers that are associated with company status.
- The necessary transparency of the CIC annual report may be considered too intrusive to the company's dealings.
- The right to distribute profit and pay directors may be unattractive to some funders.

6. INDUSTRIAL & PROVIDENT SOCIETY – COMMUNITY BENEFIT SOCIETY

An Industrial and Provident Society ('IPS') can come in to forms:

a Community Benefit Society (known as 'Bencom') which benefits persons other than its members; and

a 'Bona Fide Co-operative' which benefits the members and therefore cannot be charitable. A Co-op can be a workers Co-op or a broader consumers Co-op. Consumer Benefit Societies have an asset lock and carry on an industry, business or trade for the benefit of the Community and can be either charitable or non-charitable.

6.1 Regulation and Structure

An IPS is a separate legal entity with limited liability that registers with the Mutual Societies Registration which is part of the Financial Services Authority. Annual returns and accounts are delivered to the FSA. It is also listed at Companies House but despite this, an IPS is not a company. An IPS is primarily regulated by the legislation contained in the Industrial and

Provident Societies Acts 1965, 1967 and 2002 and the Friendly and Industrial and Provident Societies Act 1968 and the Co-operatives and Community Benefit Societies Act 2003.

Such societies are governed by a set of Rules which can be amended subject to certain provisions. These Rules state what the objects of the Society are, what the Society has the power to do, what will happen to any surplus assets or assets on dissolution, whether directors can be remunerated, the nature of the membership, the appointment and removal of directors, how to hold meetings, minimum share capital, how shares can be withdrawn and general accounting matters.

6.2 Types of IPS

Co-Operative societies are run for the mutual benefit of their members, and profits are usually fed back into the society to provide better services and facilities, and as a result are not a suitable vehicle for a charitable society.

Community Benefit Societies (or 'Bencoms') provide services for people other than their members and their business is in the interest of the community. A Bencom must be able to show that the business is run primarily for people who are not amongst its members, and be in the interests of the community at large, the Rules must not allow profits and assets to be distributed to its members, including on dissolution where any such assets should be passed to an IPS with similar purposes. Member control is permitted, and is actually a requirement under the one member/one vote rule. It was the primary form for a not for profit company before the company limited by guarantee was created and special reasons are now needed to justify registration as a Bencom rather than a company.

6.3 Charitable Status

Currently, even if an IPS which is a Bencom has exclusively charitable rules it is not registrable with the Charity Commission although it may apply to HMRC for recognition as a charity. If it is recognised it will become an 'exempt' charity. Exempt charities cannot yet be registered with the Charity Commission and will therefore not receive a charity registration number, however they can still take advantage of the tax benefits that are available to charities including the mandatory 80% reduction in business rates and corporation tax exemptions. It will also be considered a charity for Gift Aid purposes. Most charity legislation does not apply to exempt charities.

Changes due to be implemented under the Charities Act 2006 mean that charitable IPSs will lose their exempt status and will be required to register with the Charity Commission. These changes are not yet in force. Initially only charitable IPSs with annual income of over £100,000 and not regulated with another body such as the Tenants Service Authority will be required to register.

6.4 Members and Directors

Members may purchase up to £20,000 of shares in a Society unless the Rules specify a lower amount and their liability is limited to the amount unpaid on the purchase of these shares.

6.5 Advantages of the IPS Structure

- The IPS structure is good for social investment due to the potential investment by each member and the ability of the Society to repurchase the shares from its Members, or for a member to sell their shares back to the Society. Such shares do not increase in value. IPSs do not face the difficulties of private companies which are not allowed to

ask the public to buy shares. Other IPSs can invest more than £20,000 in shares of the society, making co-operation with other IPSs possible;

- The legislation governing operation is fairly simple, for example, any retirement or appointment of directors need only be filed with the FSA once a year (although it is not inconceivable that similar filing requirements to companies will be introduced);
- A society's Rules must remain not be adapted to prevent it from acting as either a Co-Operative or a Bencom making it more difficult for a changed board of directors to hijack its aims, in comparison to a company limited by shares.
- Industrial and Provident Societies are free from some of the restrictions which apply to the shares of companies; it has no restriction on reduction of share capital and a Society can buy back its own shares if the Rules allow which allows the share capital to fluctuate.
- Societies can now have an asset lock preventing misuse of reserves.

6.6 Disadvantages of the IPS Structure

- The IPS is not a strong brand and is not understood by many people.
- There is a requirement to show on registration why the society is being registered as an IPS rather than a company limited by guarantee.
- Registration is more expensive (£950.00 for the registration fee of free standing Rules or £350 if no more than ten amendments are made to Co-operatives UK's Model Rules) and slower (often one to two months) than for companies. In addition a periodic fee is payable to the FSA each year following the one in which the IPS is registered.
- Members shareholdings are subject to a maximum limit set by HMRC (although there is no limit for other Industrial and Provident Societies and vice versa).

7. NON-CHARITABLE NOT FOR PROFIT COMPANY

7.1 Regulation and Structure

Not-for-profit companies limited by guarantee have a very similar internal legal structure to charitable companies (see above), but with the main difference being that their objects do not have to be exclusively charitable and directors can be paid as employees.

Typically there is a lock on assets in the Memorandum which requires funds to be spent on the company's objectives and for any funds not to be distributed amongst members; however this can be reversed by special resolution. The real issue here is that there is not the same level of regulatory control as there is for a charity meaning that by special resolution the objects could be changed to make the company 'for profit' with little recourse to a regulatory body should this happen.

7.2 Advantages of Not For Profit Companies

- Much more flexibility in its activities and the ability to trade without the constraints of charity law;
- Less regulation generally;
- Directors can be paid for their services as directors

7.3 Disadvantages of Not For Profit Companies

- No charitable tax reliefs, although some local authorities permit limited rate relief;
- The asset lock can be removed and funds distributed.
- Some funders prefer to see more restrictive provisions for the remuneration of directors, for example those remunerated must be in the minority, or directors should be on management contracts rather than be employees;
- Some funders are prohibited from making grants to this type of company, partly because the lock on assets can be reversed by a special resolution, and partly because they are charities themselves and can only transfer funds for exclusively charitable activities. This can prove to be a major stumbling block;
- There are no tax advantages.
- No regulator to check that funds are not leaked out to staff or those who control the organisation.

8. OUR RECOMMENDATIONS

Our recommended legal structure is that of a charitable company. This is a reliable, well-known and established structure. It has the financial benefits of charity status including certain tax exemptions, rate relief, and the recovery of Gift Aid. The liability of members and directors will be limited.

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