

Adopting a Structure - A Legal Guide

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Co-operative Principles
Legal Structure Questionnaire

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1. What is the Wales Co-operative Centre?

The Wales Co-operative Centre is a co-operative development agency that supports the development of co-operatives and social enterprises. It also helps to tackle social exclusion and bring economically inactive individuals back into the world of work. In undertaking this aim it has developed a range of products detailed in 'A Guide to the Wales Co-operative Centre'.

The Centre was established in 1982 by the Wales TUC as an Industrial and Provident Society – a non-profit making voluntary organisation with open membership. Since 1982 the Centre has helped set up over 1,000 businesses across Wales and continues to support existing businesses through a range of business support and training services. Today it is the largest co-operative development agency in the UK. Its team of business advisors work right across Wales, empowering individuals and communities to take control of their future and establish businesses which have social and ethical goals as well as sound economic objectives.

What Services Can We Offer?

The Centre delivers a range of business support services that are available to anyone considering setting up a co-operative business, existing co-operative businesses and other forms of social enterprise across the whole of Wales. It also provides support to individuals on benefits who wish to set up their own business through the Enterprise Rehearsal Project and delivers projects aimed at tackling social and financial exclusion. These services can be broken down as follows:

- Business Advice – business planning, financial planning, employing people, purchasing a business

- Legal Structures Advice – internal management structures, organisational structures and assistance with setting up a legal entity
- Structured Training and Workshops – a range of planned, accredited courses

What are Co-operatives?

A co-operative is simply a business that is owned and controlled by its members. There are a number of different types which help explain in more detail what they are and what they can deliver.

- Employee Owned Business – businesses normally set up from an employee buyout of an existing business, owned and controlled by the employees
- Co-operative Social Enterprise - A business set up and run by a group of people to deliver a product or service for their community. Normally a geographical community but sometimes a community of interest
- Co-operative Consortia – a number of individuals or businesses coming together for a common purpose such as joint marketing, sharing resources or owning assets.

The Wales Co-operative Centre ensures it provides a range of services that meet its core values. We have therefore developed a range of additional projects and activities that complement our co-operative development activities and include community development activities and project management services.

- Enterprise Support – delivered through a Social Enterprise Support Programme that aims to raise awareness of social enterprise and provide practical support.
- Digital Inclusion – through a Welsh Assembly Government sponsored Communities 2.0 Project aimed at developing ICT projects within communities

- Financial Inclusion – looks to support the development and growth of credit unions in Wales and promote financial inclusion awareness.

Introduction to Legal Structures

A group of individuals wishing to form themselves into some form of legal structure will either become an *unincorporated organisation* or an *incorporated organisation*. The remainder of this guide explains in detail these options.

2. Unincorporated Organisations

A group of individuals have a series of choices to make when considering developing the project or activity they are involved with. The first decision will be to adopt a formal legal structure that brings together a group of individuals into a recognised organisation. In doing so the decision is either to become an *unincorporated organisation* or to register as an *incorporated organisation*.

An Unincorporated Organisation is an organisation that exists as a group of individuals or members who have jointly come together for a common purpose. Any unincorporated organisation should adopt a formal governing document irrespective of its scale and aims. The governing document will ensure anyone involved with the organisation is clear as to what it has been set up to do, who is eligible to become involved and how it organises itself and should cover:

- The name of the organisation
- Its objectives and powers
- Who can be a member
- How and when members meet
- How decisions are made
- What will happen to the assets of the organisation if it is wound up

Other issues may well be included but these are the main elements. The governing document in an unincorporated organisation is often called its constitution or rules. This organisation can undertake its activities as it sees fit but it will have the following characteristics:

- Acts as a group of individuals
- Not a recognised legal form that is separate from these individuals
- These individuals can collectively employ people, own property and sign contracts in the name of the organisation but in the eyes of the law they and the organisation are the same
- If the unincorporated association owns or takes a lease of property, holding trustees must be appointed who are normally separate from the managing committee of the organisation

Unincorporated organisations have been set up for a wide range of groups and businesses. For example, an after school club or organised leisure activity will often remain unincorporated. Groups of individuals forming partnerships to share resources such as in the art and craft sector and community based projects such as youth clubs and small community cafés may well also remain unincorporated. The majority of community associations and the management committees of community buildings are often unincorporated organisations.

Model governing documents are available for unincorporated bodies from the Wales Co-operative Centre and many county voluntary councils (CVC's).

3. Incorporated Organisations

An Incorporated Organisation is an organisation that has taken the decision to incorporate as a recognised legal form separate from the individuals involved. It differs from the unincorporated association in this key respect in that it:

- Becomes a legal entity in its own right.
- Can employ people, own property, receive grants and borrow money.
- Can sue and be sued.
- Can sign and deliver contracts.
- It can do all these things in its own right independently of the individual members' personal responsibility.

There remain further choices to make if the organisation has decided to incorporate.

Again, the decision is a choice between two overarching options:

Should incorporation be as:

- i) a Limited Company; or
- ii) an Industrial and Provident Society

Limited Companies

The limited company is the most popular form of incorporated structure that organisations can adopt. This is true of community based organisations, non-profit distributing organisations and the private sector. They are therefore widely recognised and understood by banks, public bodies and other businesses.

The concept of the limited company is a simple one. By registering as a limited company the organisation becomes a recognised legal entity that is separate from the members who make it up. It can carry out all of the activities of an organisation such as employing people, receiving and making grants or owning assets - as an entity in its own right. It will always be a group of individuals (or organisations) acting collectively within an agreed set of rules.

There are three types of limited company:

A Company Limited by Shares

A company limited by shares is often seen as the most appropriate structure for a profit distributing company that aims to provide a service or make product at a maximum profit with a view to returning part or all of those profits to shareholders in the business. It has strict controls on its ability to raise money from the public or a specified group of people to help set it up and run it.

A Company Limited by Guarantee

A company limited by guarantee does not have shares (share capital) and therefore cannot raise money in the same way. It is often seen as the most appropriate company structure for a non-profit distributing company set up for the benefit of a defined community. Its objectives often have a social focus rather than purely financial. However, like any company it should always act properly and aim to, at worst, break even. It is likely to have specific rules setting out how any surplus should be used which might include, for example, reinvestment into the business or to support activity within the community in which it operates. It often benefits from access to grants not always available to other company structures.

Community Interest Company

The Community Interest Company (CIC) is a new type of company, designed for social enterprises who want to use their profits and assets for the public good. CICs are 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. CICs will report to an independent regulator on how they are delivering for the community and how they are involving their stakeholders in their activities.

CICs will need to convince the regulator that it has been set up to benefit a community and passes a community interest test. Cic's also have to produce annual community interest reports.

Companies are registered with Companies House in Cardiff and are subject to the Companies Acts. There are models available for both companies limited by shares and companies limited by guarantee from the Wales Co-operative Centre.

Industrial and Provident Societies

Industrial and Provident Societies operate in the same way as a company. Most Housing Associations are Industrial and Provident Societies and the retail co-operative movement is based on the legal form of an Industrial and Provident Society. Whilst they are perhaps not as widely recognised as companies they have a number of advantages over the company structure.

There are two types of Industrial and Provident Societies:

Bona Fide Co-operative Society

A bona fide co-operative society, like a company limited by shares, is an appropriate structure for a democratic profit distributing organisation that aims to provide a service or make a product at a profit with a view to returning part or all of those profits to the members of the co-operative.

Its greatest advantage over a company limited by shares is that it does not have the strict controls over its ability to raise money from the public or a specified group of people to help set it up and run it. Its members should be paid a limited return on capital.

The current maximum shareholding in an Industrial and Provident Society is £20,000 of share capital. However, other Industrial and Provident Societies are allowed to invest without limit in the shares of an Industrial and Provident Society.

Society for the Benefit of the Community.

A society for the benefit of the community can also issue shares to its members in the same manner as a bona fide co-operative. However, many of them prefer to issue only one share which is simply for membership purposes. A society for the benefit of the community must demonstrate why it should not be formed as a company as part of the registration process. One reason is that it is very simple for a society to issue shares which usually retain the value of £1 and do not go up in value.

A society has the advantage over a company limited by guarantee in that it is not only recognised as a not-for-profit organisation which can receive grants and has a social rather than a financial focus but it can also issue shares for social investment purposes as another way of raising capital. The objects have a social focus rather than a purely financial focus but like any company it should always act properly and aim, at worst, to break even.

Societies are registered with the Financial Services Authority (FSA) in London and are subject to Industrial and Provident Societies Acts. There are models available for both bona fide co-operatives and societies for the benefit of the community from the Wales Co-operative Centre.

Share Company or Guarantee Company?

A share company is seen as a profit making enterprise. This is because it effectively borrows money from its members to invest in the business with a view to generating profits for its members. A shareholder will not normally purchase shares if he/she cannot expect a greater financial return on their investment than they would get in the building society. The share company is owned by the shareholders who will appoint the board of directors as shown in the Company's articles of association. Income for the business can be generated from the issuing of shares.

The guarantee company is often seen as a non-profit making company. Although we prefer to use the phrase non-profit distributing. It cannot issue shares because it cannot provide a return to potential shareholders. Guarantee companies will normally provide a service for the benefit of a defined community and aim to break-even or invest surpluses back into the business. They cannot pay dividends to directors, employees or members and company assets are held in 'Common' – they must be transferred to similar organisations if the company is wound up. There are no shares and therefore no shareholders. As there is no means of attracting working capital from shares, guarantee companies often require funding from grants to pay for capital and revenue costs. Guarantee companies will stipulate these characteristics in their Memorandum and Articles of Association.

4. Legal Implications of Incorporation

An organisation may have its own reasons for considering incorporation. However, all members of a co-operative should be clear as to why they should consider legal registration and what the implications of this are.

- The business becomes a legal entity that exists separately from the membership and therefore continues to exist in spite of changes in membership.
- It can take legal action in its own name, it can own property, enter into contracts, sue and be sued and it can open a bank account in its name.
- It has limited liability. This is normally essential when a group has one or more of the following characteristics: a high turnover; employs staff; signs contracts; owns property; gives credit.
- It becomes a legal form recognised by potential funders and supporters. In some instances grant funders, loan funders and banks may insist on incorporation.
- By adopting a constitution clarity of business structure is obtained and by incorporating co-operative principles the business can be identified in law as benefiting its members.
- If a group remains unincorporated but has a drawn up constitution and a membership register, then all members can be liable for any debts incurred by the business. Once incorporated, the Directors of the company become the legal managers and, in the eyes of the law, have special duties and responsibilities.

Legal Implications and Registration Procedures

A group becoming incorporated as a limited company will require the following:

- Agreed Memorandum and Articles of Association
- At least one first director to sign the Memorandum and Articles of Association
- A Company Secretary different to the first director
- A registered office where official company mail can be sent and will be opened
- The funding in place to pay any set up costs
- A completed business plan is also recommended

In addition to the above it is recommended that the first directors receive the appropriate training to ensure they have a clear understanding of their legal duties and responsibilities. The Wales Co-operative Centre can arrange this.

Once established the Company will be legally managed by the Directors (often more than one person operating as the Board of Directors or Management Committee). The directors are seen as agents of the company and trustees of the company's assets.

The Company secretary has a legal responsibility to ensure the rules of the Company as laid out in the Articles of Association are adhered to and as a legal minimum at least one annual general meeting is held for all company members.

Annual accounts must be drawn up and returned to Companies House with the completed annual return – a filing fee is payable to Companies House.

All registrations can be directed through the Wales Co-operative Centre. The procedure is not particularly difficult but can be time consuming. It is therefore very important that everything is completed accurately and correctly, as both Companies House and the Registrar of Friendly Societies are quick to pick up errors. Prior to selecting the most

suitable constitution it is important for a *Legal Structure Questionnaire* to be completed. This is available from the Wales Co-operative Centre and will be completed with the support of the Wales Co-operative Centre's staff.

Memorandum and Articles can be drafted to suit individual requirements, such as share or guarantee companies, non profit making, common ownership of assets, structure of membership and board etc. Some funders will request that certain clauses are contained in the groups' memorandum or articles to make them eligible - the Centre can also advise on these. The first directors of the business must sign both the memorandum and articles that are in turn signed by a separate third party. Your Registration Certificate, Company Kit with copies of the Memorandum and Articles should be with you in three weeks. This complete service can be provided in Welsh and English.

5. Charities, Charitable Companies and Trading Arms

Charities

A charity is an organisation that has been established for and incorporates charitable objectives. The law has accepted six 'heads' to classify what is charitable. These are:

- The relief of the poor, the handicapped and the aged;
- The advancement of education;
- The advancement of religion;
- The relief of unemployment
- The promotion of urban and rural regeneration
- Other purposes beneficial to the community not falling under any of the other three heads.

Above all, the purpose of the charity must be for public benefit. It must be of actual benefit and it must benefit the public as a whole or a sufficient section of the public. The major advantages of setting up a charity is the relief gained on tax and rates, public perception and the possibility to attract grant funding from local government, the public and grant making trusts.

A charity can be established in one of three ways:

1. *A charitable trust* - governed by a trust deed and normally set up to manage property and other assets, non trading and unincorporated.
2. *An unincorporated association* - a structure chosen by a group aiming to have a continuing membership and wishing to undertake a charitable activity. Governed by a constitution.
3. *A charitable company* - a limited liability company governed by memorandum and articles of association.

Of these structures, only the company provides limited liability for the trustees. This is the structure the Wales Co-operative Centre is able to establish using model memorandum and articles of association.

Charitable Companies

A charitable company will enjoy the advantages of the charity but also the advantage of the company limited by guarantee - the members agree to contribute to any debts of the organisation up to sum normally not exceeding £1. Memorandum and articles of association identifying its charitable objectives will govern the charitable company. A minimum of three director/trustees will be required to sit on the board.

The constitution of the charitable company must stipulate common ownership (assets do not belong to the members), non distribution of profits to directors and employees are not normally allowed to sit on the board. Trading by charitable organisations is allowed within certain specified limitations.

There are two types of trading which are specifically sanctioned by legislation.

- i) Trade undertaken in the course of carrying out a primary purpose
- ii) Trade carried out by the beneficiaries of the charity itself

In both situations all income generated is ploughed back into the business to carry out the main objectives of the charity.

Trading Arms

There are two sides to the coin. On the one side there is the charitable organisation that recognises that it has a product which it can market, sell and make money on but wishes to retain charitable status and the advantages of that. On the other side there is the trading organisation that recognises that part or all of what it does is for the benefit of the community and the activities of which are, by most standards, considered charitable. The method of avoiding the trading restrictions is to establish a charity with a separate trading arm or to establish a trading company with a separate charitable arm and allow the trading arm to transfer its profits direct to the charity. However, there are also limitations on this:

- Establishing the trading arm cannot involve an investment by the charity (not a problem in the reverse situation - a trading company can establish a charity)
- Proper administrative arrangements must be made between the trading arm and the charity ensuring they are entirely separate
- The majority of directors of the trading arm should not also be trustees of the charity

- Profits from the trading arm can be distributed to the charity in three ways, but each has a specific problem to overcome and an accountant should advise:
 1. Deed of Covenant (paid before profits are declared)
 2. Payment on the dividend (must pay Advance Corporation Tax)
 3. Gift Aid (paid before profits are declared, must be different directors)

Each method, if successfully implemented, will allow the trading company to avoid paying the majority of its corporation tax bill.

6. Further Information

The Centre publishes a range of Guides providing some further information. In addition, if there are questions you would like answered or you wish to speak to someone directly, please feel free to contact the Centre at the address below or one of the addresses or telephone numbers given on the back page of this Guide. You can also visit our website at www.walescoop.com.

The following Wales Co-operative Centre Guides are available:

- A Guide to the Wales Co-operative Centre
- Making it Happen - A Guide to Business Planning
- A Guide to Employing People
- The Well Managed Business
- Set up and Maintain the Books
- Co-operative Development Toolkit

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Co-operative Principles

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise.

Voluntary and Open Membership

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination. Categories of membership can be defined and equal representation from different categories can be guaranteed through the constitution of the organisation.

Democratic Control

Co-operatives are democratic organisations controlled by their members who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership and it is through the legally required annual general meeting where the members elect them. Most co-operatives have equal voting rights (one member, one vote) and most decisions are made by majority vote unless a 75% majority is specified in law.

Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive a limited compensation of any of the capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes; developing their co-operative by providing for reserves, benefiting members in proportion to their transactions with the co-operative or through a suitable trust scheme, and supporting other activities approved by the membership that may be social and /or charitable.

Autonomy and Independence

Co-operatives are autonomous, self help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers and employees so they can contribute effectively to the development of their co-operative. They inform the general public about the nature and benefits of co-operatives.

Co-operating With Other Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, regional, national and international structures.

Concern for Community

Co-operatives work for the sustainable development of their communities through environmentally and socially responsible policies approved by their members.