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1.1. Foreword by the Regulator

On 1 April 2005 the Secretary of State for Trade and Industry appointed John Hanlon as the first Regulator of Community Interest Companies and on 1 July 2005 the legislation, which provides the rules on the creation and operation of community interest companies (“CICs”), came into force. The office was opened to receive applications from organisations based in England, Wales and Scotland on 25 July 2005 and on 6 April 2007 further legislation came into force making it possible to form, or to convert to, a community interest company in Northern Ireland. On John’s Departure in April 2007 there were 1040 Community Interest Companies on the register.

In September 2007 The Secretary of State for Business, Innovation and Skills appointed me as the new Regulator for Community Interest Companies to promote the Community Interest Company vision and generally raise the profile of Community Interest Companies. Together with the team in the Regulator’s office I will be endeavouring to ensure work continues to establish the CIC as a name you can trust.

The role of my office is to help establish CICs and provide guidance to enable CICs to be formed and regulated with the minimum of interference so long as they do not fail to meet their obligations both to the law and their community. I would like to emphasise that it is not intended that I should be a heavy-handed Regulator, and that my role with CICs and the social enterprise sector is to develop CICs and encourage their use for suitable enterprises. As the first registered CICs submit their annual reports we are building a body of information about the many different ways in which CICs are doing this.

CICs are being recognised more and more as an effective legal form for social enterprises. They are particularly attractive to those wishing to enjoy the benefits of limited company status and to make it clear that they want to be established for the benefit of the community rather than their members but are not able, or do not wish to become charities.

The CIC form aims to meet the needs of organisations which trade with a social purpose (“social enterprises”) or carry on other activities which benefit the community. The different available formats of companies (limited by guarantee, public or private companies limited by shares) and the ability in some cases to pay limited dividends give a flexibility to tailor the CIC form to particular needs.

The familiar structure of shareholders and directors is an easily understood corporate governance system and the people you deal with such as banks, suppliers and advisers will be used to dealing with a company. The ability to pay salaries to directors may assist in obtaining the right quality managers.

The asset lock provision is increasingly giving confidence to those wishing to fund CICs and those dealing with CICs that the assets and profits will primarily be devoted to the benefit of the community rather than rewarding the owners or investors. The CIC annual report ensures transparency and that those affected by and benefiting from the CIC's activities are being properly recognised as stakeholders.

Many CICs either undertake activities to generate profits to support a community purpose (such as charity shops), or activities which are in themselves a community purpose (such as day care centres for the elderly). The CIC brand can also stretch to less traditional activities and be put to imaginative uses such as providing commercial support services or recreational facilities and assisting people both here and abroad in their every day lives and to improve their quality of life.

We have received applications the length and breadth of the UK, from (community groups working with) local authorities to established social enterprises, from local village shops to radio stations. CICs are providing services related to city centre regeneration, recycling centres, restaurants and community cafes. They are providing health, transport, education and environmental services and are benefiting, children with special needs, pensioners and young people.

A CIC is first and foremost a limited company carrying on a social activity and must be viable as such. A CIC carrying on a business will need to generate surpluses to support its activities, maintain its assets, make its contribution to the community and in some cases make a limited return to its investors. Other CICs may well depend on grants or donations to achieve these ends.

The phrase "not for profit" is frequently used in this area. This can be misleading and should only be used in the context of the company not having as its primary purpose the generation of profits for private investors. If a CIC fails to make profits from its activities (or in some way generate sufficient income to cover its running costs) it will eventually fail altogether. Therefore rather than thinking in terms of CICs being non-profit making they should be thought of as making profits for their community purposes.

As a limited company a CIC must act as such and comply with company law generally as well as the special CIC legal requirements.

Forming a CIC is a major step with permanent effects. It is important that you understand these before you proceed. Please therefore read these guidance notes carefully. I am sorry they will of necessity be lengthy in order to cover the whole area but please do not be put off by this. If you read the overview in Chapter 1.3 this should give you a basic understanding and you can then select the topics of interest to you from the contents list.

We see the production of guidance notes as an evolving process and welcome comments, suggestions and contributions. They will be regularly updated in the light of experience and feedback. We are all still on a learning curve and the more feedback we get the better job we will be able to do.

If in doubt seek professional advice. The Regulator's office is happy to provide general information and guidance and will be pleased to discuss aspects of CICs with you; they cannot, however, prejudge an application before it is made or provide detailed legal, accounting or financial advice on particular projects.

I very much look forward to working with communities across the country to build the CIC brand and as a means of delivering services, as well as financial and other benefits to the communities, which CICs exist to serve.

A handwritten signature in black ink, appearing to read 'S. Burgess', with a stylized flourish at the end.

Sara Burgess

October 2009

1.2. Legal background and basis of this information and guidance notes

These guidance notes are produced by the Office of the Regulator of Community Interest Companies to assist those who may wish to form a CIC, other stakeholders and those giving professional advice about CICs. The views expressed are those of the Regulator in her capacity as an independent public office holder.

1.2.1. The principal legislation governing CICs

The principal legislation covered is:

- ❖ the Companies Act 2006, subordinate legislation made under that Act, and related legislation, such as, the Insolvency Act 1986. These are generally referred to in this guidance as the “Companies Legislation”, and
- ❖ the specific law creating and regulating CICs is in the Companies (Audit, Investigations and Community Enterprise) Act 2004 Part 2 and Schedules 3 to 7 and subordinate legislation made under the Act. In this guidance this is referred to as “the Act” or “CAICE Act”.

1.2.2. Links to the legislation

- ❖ The Companies (Audit, Investigations and Community Enterprise) Act 2004
- ❖ The Companies (Audit, Investigations and Community Enterprise) Act 2004 (Commencement) and Companies Act 1989 (Commencement No 18) Order 2004 (SI 2004/3322) (C.154) brought the provisions relating to the appointment of the Regulator of Community Interest Companies into force on the 1 January 2005 and the remaining provisions relating to CICs to came into force on 1 July 2005.
- ❖ The Community Interest Company Regulations 2005 contain detailed provisions relating to CICs. In this guidance these are referred to as the “Regulations”. The Regulations came into force on 1st July 2005.
- ❖ The Community Interest Company (Amendment) Regulations 2009, in the main, contain provisions to enable Scottish charities

to convert to a CIC; for a CIC to convert to a permitted industrial and provident society; and some minor changes to the statutory articles in Schedules 1, 2, & 3 of the Regulations.

- ❖ The Companies Act 2006
- ❖ The Companies Act 2006 (Consequential Amendments etc) Order 2008 contains consequential amendments relating to the CIC report.
- ❖ The Companies Act 2006 (Consequential Amendments) Order 2009 contains consequential amendments to bring the CIC legislation in line with Company legislation.

1.2.3. Disclaimer

These notes seek to interpret and explain the legislation that relates specifically to CICs and give guidance on its application. They are not a full statement of the law, which is set out in the legislation mentioned above, and they are not legally binding. While they represent the Regulator's current considered views on the topics covered in them at the time of writing, those views may change, and any such change may not always be immediately reflected in the guidance. They will be updated from time to time in the light of experience, comments received and changes in the law.

In particular, the Companies Act 2006, which received Royal Assent on 8 November 2006 (brought fully into force on 1 October 2009), replaced much of the Companies Act 1985. This necessitated changes to CIC legislation to take into account changes in the underlying company law rules.

Further updates and editions of this guidance will keep you informed of the impact of these changes on CICs, which will be matters of process rather than substance.

The notes will be a virtual loose leaf reference book; we do not intend to issue hard copies at present but will provide up-to-date print outs (of the full notes or parts) on request. You are free to download the material and make use of the forms.

We welcome comments on the notes and suggestions for other subjects, which could be usefully covered either in the notes or in the "Frequently Asked Questions" feature on the web site.

1.2.4. Contact point for issues about the legislation

We are here to administer the legislation and develop awareness of the CIC brand. We cannot change the law. Therefore, if you have comments on the Act or Regulations as such these should be addressed to:

- ❖ Corporate Law and Governance Directorate, Department for Business, Innovation and Skills, 1 Victoria Street, London SW1H OET.

If you have comments on Government policy towards CICs, or social enterprises, more generally, you should address them:

- ❖ Office of the Third Sector, 2nd Floor, Admiralty Arch, South Side The Mall, London SW1A 2WH

In either case, we would be interested to receive copies of any such comments.

1.3. An overview of CICs

CICs are a new type of limited company for people wishing to establish businesses which trade with a social purpose (“social enterprises”), or to carry on other activities for the benefit of the community.

Many social enterprises and community organisations are already incorporated as companies (usually limited by guarantee), while others, such as co-operatives, take the form of industrial and provident societies. Many operate less formal legal structures, for example, with assets held on their behalf by trustees.

The CIC will be a valuable addition to these forms and particularly suitable for those who wish to work within the relative freedom of the familiar limited company framework without either the private profit motive or charity status. They are more flexible than some other legal forms and there are a variety of capital structures available to meet the needs of members and the organisation.

It is intended that the CIC will prove attractive to a wide range of individuals and organisations wishing to participate in social enterprises. CICs will be a useful vehicle for enterprises of all sizes from a small community care project to a large organisation providing international fair trade type distribution systems for the benefit of overseas producers.

CICs could be a useful legal form for holding local assets such as community halls and facilities, as well as for trading in a conventional sense through the provision of goods and services, either directly to the public and organisations or through contracts with service providers.

Although the same body cannot be both a CIC and a charity, a CIC may well be a useful way of operating trading activity, such as, a charity shop. It could be established in such a way that it could pass some, or all, of its profits to the charity to finance its charitable activities (see below and Chapters 2).

Benefiting the community is what CICs are all about and providing that they can pass the community interest test (see below and Chapter 4) there are very few restrictions on the purposes for which a CIC can be used.

The concept of community is important to understand (see Chapter 2) as it can have a wide range of meanings from the population as a whole to the residents of a particular areas or a group of people suffering from a particular disadvantage. A

CIC cannot be used solely for the financial advantage of a limited group of people, for political purposes or for the benefit of the employees, directors or members of a single organisation.

1.3.1. Basic legal structure and special features

The basic legal structure for CICs is the limited liability company. They can either be incorporated as a new company, or converted from an existing company. They can take one of three company forms (see chapter 3):

- ❖ company limited by guarantee,
- ❖ private company limited by shares, or
- ❖ public company limited by shares (PLC).

An existing company limited by guarantee with a share capital may also be converted to a CIC.

A CIC's name must include a designation indicating its CIC status, and non-CIC companies cannot use such designations (see Chapter 2).

As CICs are intended to use their assets, income and profits for the benefit of the community they are formed to serve, they must embrace some special additional features to achieve this:

- ❖ They are subject to an 'asset lock' (see Chapter 6) which ensures that assets are retained within the company to support its activities or otherwise used to benefit the community. The main elements of the asset lock are as follows:
 - CICs may not transfer assets at less than full market value unless they are transferred to another asset locked body (such as to another CIC or a charity).
 - If its constitution allows a CIC to pay dividends (other than to another asset locked body – essentially another CIC or a charity) these will be subject to a cap that limits the amount of dividend payable. A similar cap applies to interest payments on loans where the rate of interest is linked to the CIC's performance (see Chapter 6).
 - On dissolution of a CIC any surplus assets must be transferred to another asset locked body.

1.3.2. Eligibility to register as a CIC

To register as a CIC a company must (see Chapter 2, and Chapters 4 and 5 for further information):

- Adopt a suitable constitution in the form of memorandum and articles of association that comply with the Act and Regulations (for existing companies this will involve making changes to their articles and a change of name).
- Make a community interest statement declaring that its activities will be carried on for the benefit of the community and how this will be achieved.
- Satisfy the Regulator that a reasonable person might consider that the CIC's activities are or will be carried on for the benefit of the community. This is known as the "community interest test".
- The CIC will have to continue to meet this test throughout its life. A company will not satisfy the test if it carries on certain political activities, or if a reasonable person might consider that its activities are carried on only for the benefit of the members of a particular body or the employees of a particular employer.
- Make a declaration that it will not be an excluded company (which briefly means that it must not be owned or controlled by a political party or a political campaigning organisation).

1.3.3. Other things to consider

- CICs are required to produce an annual CIC report, which will be delivered with their accounts to Companies House and placed on the public record. The report must record what the CIC has done to pursue the community interest and involve its stakeholders during the year. This will ensure that the community served by the CIC will have easy access to key information on its activities. It must also contain additional financial information such as payments to directors and declaration of dividends (see Chapter 9).
- Applications for registration of a company as a CIC are made to the Registrar of Companies in the usual way, but before the company can be incorporated the application will be referred to the Regulator to consider whether the company is eligible for CIC status (see Chapter 4).

- The Regulator will also consider other matters such as proposed changes in a CIC's objects (see Chapters 5 & 8) and the conduct of individual CICs and will maintain public confidence in CICs by her regulatory role.
- The Regulator has a range of investigation and enforcement powers to support her role and deal with CICs which are failing to comply with their CIC obligations. The Regulator is a light touch regulator and will only use these powers to the extent necessary to maintain confidence in CICs.
- The CIC will operate in the same way as any other company. They will have all the well understood characteristics of a limited company, such as, a separate legal identity; the ability to enter into contracts and own assets in its own name; and flexibility in borrowing and fund raising. The separate legal identity means that a CIC will continue to exist despite changes in ownership or management.
- The directors can be paid and will have the same rights and duties as any other directors.
- The members of a CIC will have the same governance and decision-making role as in any other company, but they (and the directors) will be under a stronger obligation to have regard to the wider community which the company serves and involve stakeholders in its activities than might otherwise be the case.
- People dealing with a CIC (such as banks and suppliers) are familiar with dealing with companies and therefore have confidence in doing so.
- CICs will produce accounts and annual returns just like any other company, which will be available on the public record. Further transparency will be achieved by the annual CIC report.
- The asset lock and other features will give confidence to those funding CICs (particularly those not looking for any financial return) that the assets will be used for the benefit of the community and not unduly benefit the CIC's members or employees.
- It is hoped that CICs will become established as a brand of company that the public recognises and trusts and whose social purpose they understand.

There may be some minor additional costs associated with the need to conform with the special requirements (including the small fees that will be charged by the Regulator) (see Chapter 4 and Annex E) but these should not be a deterrent if becoming a CIC would otherwise suit your purposes.

In practice the special features should not prove onerous or cause any difficulties. Forming a CIC should be just as easy as forming an ordinary company. It will however help if you spend a little time understanding the special features and if in doubt have an early discussion with the Regulator's Office on general matters. They cannot however act as your professional advisers on specific matters relating to your own potential CIC.