

Governance and Legal Form - Options Paper

Warden Call and Telecare Service and Community Equipment Loan Service

1. Introduction

- 1.1 York City Council currently operates a warden call and telecare service and a community equipment loan service.
- 1.2 It is proposed that a new social enterprise is established into which the two services would transfer. (the “Social Enterprise”).

2. The Social Enterprise as a Charitable Company Limited by Guarantee

- 2.1 One option is to establish the Social Enterprise as a charitable company limited by guarantee.
- 2.2 The advantages of charitable status include:
 - 2.2.1 easily understood by the public and by staff within the Council;
 - 2.2.2 tax reliefs including relief from corporation tax, gift aid on donations, rate relief, VAT treatment (see Schedule 1);
 - 2.2.3 regulated entity, giving the Council assurance as to the on-going operations of the Social Enterprise;
 - 2.2.4 may be easier to obtain grant funding should that ever become attractive.
- 2.3 The disadvantages include:
 - 2.3.1 restrictions on non-charitable trading which may necessitate establishing a trading company;
 - 2.3.2 the general rule is that the directors of charities (“trustees”) must be unpaid – this means usually the chief executive and senior management would not be trustees although it may be possible to persuade the Charity Commission to permit the chief executive to be a trustee and for one trustee to be a staff representative (see below);
 - 2.3.3 the employment of senior staff, including the chief executive, can be terminated by the trustees;

2.3.4 staff could not make final decision how surpluses should be used, this would be for the trustees but they could give recommendations.

2.4 Charity is a status that attaches to an underlying legal form rather than a legal form of itself. It is also proposed that the underlying legal vehicle of the Social Enterprise be a company limited by guarantee. A company limited by guarantee in an incorporated legal form meaning that it is able to enter into contracts (including employment contracts) and own property in its own right. It has limited liability so that its members cannot be held liable for more than the nominal guarantee of £1. Trustees will generally not incur personal liability unless it can be shown they failed to fulfil their duties as trustees.

2.5 If a trading company was established, it would be a wholly owned subsidiary of the Social Enterprise.

3. The Social Enterprise as a Community Interest Company

3.1 A CIC is a particular type of company that uses its assets and profits for the community benefit and is regulated by both Companies House and the CIC regulator. In order to be registered as a CIC, a company must show that it is established in the interests of the community; and each year the directors must complete a form demonstrating how it has met the community interest. The Articles must also conform to the statutory requirements; in particular it must have an asset lock which means that the wealth of the company can never be distributed privately to individuals or for non-community interest purposes. Therefore, the assets must be used solely for the community interest or transferred to another organisation which also has an asset lock such as a charity or another CIC. An exception to this is where a CIC is a CIC limited by shares. A CIC limited by shares can distribute a limited amount of its surpluses to shareholders - see paragraph 6 below.

3.2 The advantages of a CIC include:

3.2.1 light touch regulation;

3.2.2 it can pay its directors;

3.2.3 it has an asset-lock so stakeholders can be assured it acts in the community interest;

3.2.4 staff could be given power to decide how surpluses are used.

3.3 The disadvantages of a CIC include:

3.3.1 there are no tax reliefs;

3.3.2 they are not so widely known;

3.3.3 some VAT exemptions or zero rating may not be available (see Schedule 1).

3.4 A CIC cannot be a charity

4. The Social Enterprise as a community benefit society

4.1 A community benefit society is a type of legal form. Like a CIC, it has limited liability and must be established for the benefit of the community. It is regulated by the FSA. A community benefit society can be charity and at present has the advantage that it would only need to be registered with the FSA rather than the Charity Commission. In general, the FSA is less demanding as a regulator of charities than the Charity Commission. However, legislation has been passed, but is not yet in force, which would transfer responsibility for charitable community benefit societies from the FSA to the Charity Commission. It is expected to come into force relatively soon, although the date has slipped a number of times.

4.2 The advantage of a charitable community benefit society rather than a charitable company limited by guarantee is therefore that, in the short term, it is not regulated as closely as charitable community benefit society as compared to a community interest company limited by guarantee. The disadvantages of both sorts of community benefit society is that it is a less well known legal form than a company, the law relating to it is not so well developed (meaning that legal questions are not always clear) and the fees for registration are higher (£35 for a CIC and between £40 and £950 depending on whether model rules or bespoke rules are used for a bencom).

5. Why not a charitable incorporated organisation?

5.1 The charitable incorporated organisation is a new legal form which is expected to become available by early 2013. It has the advantage that the sole regulator will be the Charity Commission

rather than both the Charity Commission and Companies House. It is envisaged that it will be used by smaller organisations which find the dual regulation a burden. There is some uncertainty around the ability of CIOs to give security (and therefore access secured lending) which has yet to be resolved.

- 5.2 Given the familiarity of the senior staff likely to be running the Social Enterprise with the company form and the uncertainty around the charitable incorporated organisation, it was decided a company limited by guarantee would be preferable.

6. Why not a company limited by shares or co-operative society?

- 6.1 Some organisations spinning out of the public sector are established as companies limited by shares with the employees each holding a share in the company. At the meeting we discussed the fact that while it was important that staff were given a sense of control over the organisation and were remunerated in a way that properly reflected their contribution; it was not thought appropriate that they would receive shares. The process of issuing/transferring/buying back shares is relatively complicated and will require the Social Enterprise to pay for support to ensure it is done correctly. It was thought that staff would be content to receive “bonuses” or “performance related pay” rather than dividends if the Social Enterprise made a significant surplus. A charity and a CIC can both pay ‘bonuses’ or ‘performance related pay’.
- 6.2 We also discussed the option of setting up a Co-operative Society. A co-operative society is established for the benefit of its members (which in the case of many public sector spin outs are the staff) and had democratic, one member, one vote structure. The Social Enterprise will not be established for the benefit of its members but for the benefit of the community it works for and so this vehicle was not thought appropriate.

7. Membership

- 7.1 Companies have a two tier structure. The directors (often described as trustees if the company is charitable) manage the company and are responsible for the day to day running of the company. The owners of the company are its members, who have

ultimate control. There are various membership arrangements possible, including the following options:

Option 1: For a community interest company only - directors as members, staff as members

- 7.2 The members of the company could be the staff. This would mean that every member of staff would own the company and as a collective would be able to appoint and dismiss the board. A majority decision of the members can remove a director/trustee.
- 7.3 The powers of members also include the power to change the name of the Social Enterprise or to change its articles of association. The latter requires a 75% majority under normal circumstances but this could be increased to 100% if that was preferred. We discussed including a provision requiring the CEO to be on the board being entrenched so that a 100% majority was required. However, this would not prevent the board dismissing the CEO.

Option 2: For a charitable company limited by guarantee or a community interest company limited by guarantee – directors as members, staff as “staff members”.

- 7.4 A common option for social enterprises is for each individual appointed as a director to also become a member. It is usually chosen for organisations where the delivery of services takes precedence over democratic accountability and quick decision making is required. It is recognised in those cases that although giving staff a voice may lead to service improvements, staff may not want to fully engage with the organisation as members in company law. They may not, for example, be prepared to attend relevant meetings or read relevant papers so as to be able to exercise their rights as members responsibly. Consequently, this option suggest that staff are appointed as staff members without full rights in company law as members but with the right to appoint a staff representative to the board (see paragraph 8 below). The staff representative would be a member.

Option 3: For a charitable company limited by guarantee or a community interest company limited by guarantee – a wide group of members is appointed comprising users and supporters as well as staff.

7.5 This does not seem an appropriate option as there is no current group which would wish to be involved in this way. This option is usually taken by organisations which seek to be representative in some way or where democracy is intrinsically important to them (such as Amnesty International). This is not the case here where the main aim is the delivery of excellent services.

8. The Board of Directors and committees

8.1 At our meeting we discussed the following options:

8.1.1 For a charitable company limited by guarantee:

- (a) The CEO (provided the Charity Commission are satisfied that is necessary) appointed ex officio (by virtue of their employment);
- (b) A staff representative (provided the Charity Commission are persuaded that is necessary) elected by “staff members”;
- (c) Two co-opted trustees appointed by the board;
- (d) One trustee appointed by the local authority.

8.1.2 For a community interest company limited by guarantee;

- (a) The CEO appointed ex officio (by virtue of their employment)
- (b) Senior staff members appointed ex officio (by virtue of their employment)
- (c) A staff representative elected by staff as members or “staff members”
- (d) One or more co-opted directors appointed by the board
- (e) One director appointed by the Local Authority.

8.2 We also discussed setting up an advisory committee which would report to the board of directors. This would include external stakeholders such as local authorities and community organisations. The board would set the terms of reference for the committee.

8.3 The Charity Commission’s general preference is that trustees are not paid and it will ask for a detailed argument as to why the CEO or a person paid as a member of staff needs to be a trustee. This

is a subject which is currently making headlines in the charity press (see Third Sector 20th November) following Lord Hodgson's review of charity law which recommended that trustees should be paid. We have had some success in persuading the Charity Commission that, in particular circumstances, including public sector spin outs such as this one, where the CEO has a particular skill set and there are checks and balances in place, a CEO should be able to be a trustee. We have also been able to persuade the Charity Commission, that, given the Governments' view that staff involvement improves services, a staff representative as a trustee is desirable. However, each case is different and a cast iron guarantee cannot be given.

9. Conclusion

9.1 There are three questions to be decided:

- 1) Which legal form – community interest company limited by guarantee. charitable company limited by guarantee or community benefit society?
- 2) Who should be the members?
- 3) Who should be the directors?

The answer to these questions depends on a variety of factors as noted above but principally on the financial impact of tax reliefs (and whether this is deemed important), whether staff wish to have rights as company law members, whether senior staff wish to be on the board and the perception of “charities” and “social enterprises” amongst various stakeholders.

Abbie Rumbold
Bates, Wells and Braithwaite
www.bwblip.com
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Schedule 1

VAT

1. Entity

- 1.1. There are potential tax advantages if the Social Enterprise is established as a Charitable Company Limited by guarantee (“Charity”) rather than a Community Interest Company (“CIC”)
- 1.2. There are a number of VAT reliefs available to a Charity which would not otherwise be available. Those likely to benefit the Charity are:
 - Exemption for fundraising income
 - Zero rating for certain supplies made to the charity
 - Zero rating of certain construction services *
 - Reduced rate energy supplies *
 - Disapplication of a landlords option to tax *

* Note: these reliefs would be dependent on the supplies being used for non-business activities (see below under Section 3. for a definition of non-business activities)

- 1.3. A CIC would not qualify for these VAT reliefs; neither would it qualify for relief from corporation tax. That said it may be possible to set up Charity affiliated to the CIC which could receive any surplus from the CIC as a donation in order to avoid taxation of its profits.
- 1.4. Establishing the Social Enterprise as a Charity may encourage donations from those say related to the beneficiaries of the services which would potentially attract a further 25% for the charity under Gift Aid.

2. VAT Liability of supplies

- 2.1. The services currently provided under Warden Call and Telecare Services are likely to be liable to VAT if provided by way of business. There may also be scope for zero rating in certain circumstances.

- 2.2. Legislation provides that; the supply of an alarm system designed to be capable of operation by a disabled person, to enable him to alert directly a control centre, and the services performed by a control centre in receiving and responding to calls from an alarm system is **zero rated** when supplied to a disabled person **or** by a charity for making available to disabled persons.
- 2.3. These provisions will cover some of the services provided under both Warden Call and Telecare services regardless of whether the Social Enterprise is a Charity or a CIC. Supplies to non-disabled customers will be liable to VAT at the standard rate.
- 2.4. Provided the services are taxable for VAT purposes (i.e. at 0% or 20%) then the VAT incurred on related costs would be recoverable as input tax.
- 2.5. Equipment loan under the Community Loan scheme is currently funded partly by the local authority and partly by the NHS (50/50) as such this is currently a non-business service. Going forward, if this activity was undertaken by way of business, then the reduced rate of VAT (5%) would apply to the services of installing and providing the following items:
- grab rails
 - ramps
 - stair lifts
 - bath lifts
 - built in shower seats or showers containing built in seats
 - walk-in baths with sealable doors

The standard rate of VAT would apply to other items.

3. Grant vs. Contract debate

- 3.1. The Social Enterprise will receive funding from the Local Authority and the NHS regardless of the form of entity adopted at the outset. It will be important to establish the nature of that funding because that will determine whether it is making business or non-business supplies for VAT purposes which will in turn determine whether the VAT is due on its supplies and as consequence whether any of the VAT incurred on its costs is recoverable as input tax. If funding is partly by way of grant income and partly for a charge as will be the case here, then VAT

will be recoverable in part to reflect the business/ non business split.

- 3.2. For VAT purposes it is important to identify whether or not supplies are made in the course of business rather than the sources of income. Generally if a service is provided for a charge the activity is seen as a business supply. Grants are only considered to be outside the scope of VAT if they are freely given and do not entitle the provider of the funding to any direct benefit and recent case law has shown that HMRC are willing to challenge the treatment of grant income as outside the scope of VAT in the circumstances suggest otherwise.
- 3.3. In February 2012 the Charity Tax Group confirmed its view that a grant made to a charity is not a business transaction if the body making the grant does not receive any benefit of value in direct exchange for the grant and the charity does not give a third party any benefit of value in due of exchange for the grant.
- 3.4. As such whilst the funding party may call the funding a grant, unless it is provided without any expectation of services in return it may still be seen as consideration for a supply for VAT purposes. That said simply imposing conditions or good housekeeping clauses to make sure the funding is being used for the intended purposes does not turn a grant into payment for a supply.
- 3.5. Clearly it will depend on what comprises a grant for the funders (in the context of the grant vs. procurement rules) and the conditions/ requirements for benefit that can be attached before the grant becomes subject to the procurement rules but in the case at hand if it were possible to create a direct link between the funding and the services provided these it would significantly reduce the costs.
- 3.6. Even if it isn't possible to restructure the start-up grants, consideration should be given to the arrangements with other Local Authorities with a view to improving the business/ non business ratio of income.

Ellen Main-Jeffrey
Director - VAT Team
Buzzacott LLP
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