



YORK LIBRARIES AND ARCHIVE SERVICES

LEGAL STRUCTURES OPTIONS PAPER

19 April 2013



Paper for York Libraries & Archive Services (the Service) Legal structures options paper

1. Introduction

1.1 The purpose of this paper is:

- (a) To set out legal structure options available to the Service that could be suitable for establishing an independent entity to run the Service after it has transferred out of City of York Council (**the Council**).
- (b) As agreed, this paper will outline several options but will focus on the following two charitable legal structures:
 - A charitable company limited by guarantee (CCLG); and
 - A charitable community benefit society (Bencom).

We are focusing on these two options as the initial governance scoping exercises the Service has participated in have suggested that the Council and Service staff feel it is appropriate to establish a charity.

1.2 From our discussions with the Service and Mutual Ventures, we understand that the Service and Council's current preferred option is to establish a Bencom. We also understand that it is proposed the ownership of the new organisation will be split between the community (66%) and the staff (33%). The proposed board structure is likely to include: the CEO, one staff director, two community directors, one Council appointee and two co-opted directors.

1.3 This paper does not advise on the governance structure of the new organisation (i.e. it does not advise on who should sit on the board/be members), except to the extent that the governance structure affects the legal structure options. For a summary of the Service's governance scoping work to date, please see Appendix 1.

1.4 This paper:

- (a) Outlines the legal structure options available to Explore – with an explanation of what each option is
- (b) Outlines the process and timescales for establishing a CCLG and Bencom (and registration with HMRC)
- (c) Compares the advantages of a Bencom against a CCLG

2. The legal structure options available to Explore

At paragraphs 4 and 5 of this paper we have analysed in detail the CCLG and Bencom structures. Paragraph 2 outlines some additional options.

Option 1 – Company limited by guarantee (with no charitable status)

- 2.1 This is a legal structure that is well established for not for profit entities. It is a type of company registered with Companies House that has no shareholders and therefore prevents profits being distributed to its members (i.e. no dividends), except in certain circumstances. In order to be registered as a company limited by guarantee, it is necessary to submit a straightforward application to Companies House. This can be done in one day.
- 2.2 The governance structure currently proposed by the Service would be viable for a company limited by guarantee, as there are no legal restrictions about who can serve on the board or be members of a company limited by guarantee.

Advantages

Paid directors

- 2.3 Directors of a company limited by guarantee can be paid by the company and can also be company law members.

Legal and regulatory requirements

- 2.4 Companies limited by guarantee have less external regulation and ongoing administrative requirements than a CCLG or Bencom.

Easy registration process

- 2.5 It would be possible to establish a company limited by guarantee within one day and the application is unlikely to be questioned or rejected by Companies House.

Well established legal form

- 2.6 Companies limited by guarantee are a well-established not for profit legal form that funders and banks are likely to recognise.

Disadvantages

No community or public benefit enshrined in the constitution/not a charity

- 2.7 Unlike a Bencom or CCLG, there is no public benefit enshrined in the Articles. The Council may not feel comfortable transferring the Service to a company limited by guarantee that is not legally bound to further the public/community benefit. Further, members of the public may not trust the company limited by guarantee model in the same way they would trust a charity.

Tax

- 2.8 There are no tax advantages for a company limited by guarantee, although as a not-for-profit entity, it can apply to the Council for a discretionary 20% relief from business rates.

Option 2 - Community Interest Company (CIC)

- 2.9 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 will benefit the community; and each year the directors must complete a Community Interest Report demonstrating how the CIC has benefited the community.
- 2.10 The constitution of the CIC must also conform to 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.
- 2.11 CICs can be limited by shares (and therefore pay dividends, although these are limited for CICs) or be limited by guarantee.
- 2.12 CICs are regulated by the CIC regulator who approves the registration of all CICs. The CIC Regulator is relatively light touch, similar to the Financial Conduct Authority (see paragraph 3 below).
- 2.13 The proposed governance structure of Explore could be implemented in the CIC as employees of a CIC can freely be members/directors.

Advantages

Paid directors

- 2.14 Directors can be paid and can also be company law members.

Branding

- 2.15 CIC benefits from the 'social enterprise' brand. It is not as widely recognised as the charity brand by the general public, although most funders should be familiar with CICs.

Legal and regulatory requirements

- 2.16 CICs have less external regulation and ongoing administrative requirements than a CCLG. However, all CICs have to make an annual Community Interest Report to the CIC Regulator.

Disadvantages

Regulation

- 2.17 Although less onerous than a CCLG, the CIC Regulator has extensive powers to intervene in the running of CICs in order to ensure that they conform to their community interest purpose. These include powers to investigate and appoint and dismiss Directors.

Tax

- 2.18 There are no tax advantages for a CIC, although as a not-for-profit entity, it can apply to the local authority for a discretionary 20% relief from business rates.

Option 3 – Charitable Incorporated Organisation

- 2.19 This is a new charitable legal form which has only been available since the start of this year. It has been introduced because there was a perception that it was confusing for some individuals that CCLGs were registered both with Companies House and with the Charity Commission and cumbersome CCLGs must have two regulators/file documents with both. A Charitable Incorporated Organisation (“CIO”) is registered with the Charity Commission only.
- 2.20 All of the advantages and disadvantages described below, in relation to the CCLG will apply equally to a CIO.
- 2.21 An additional advantage is that there is no requirement to file accounts, annual returns on other documentation with Companies House.
- 2.22 There are however a few disadvantages of CIOs. First, there is some uncertainty as to whether a CIO can borrow money under a mortgage and therefore to what extent banks would be prepared to lend CIOs through overdraft facilities. The CIO is also a new legal form and so is, arguably, untested and more risky as a result.

Other options?

- 2.23 We have not looked at any legal structures in this paper where the structure would not have limited liability status (i.e. would not be incorporated). Unincorporated legal structures (such as **trusts** or **unincorporated associations**) have no separate legal personality. This means if these type of unincorporated organisations enter into contracts, need to defend legal actions brought against them or need to employ people, this must be carried out directly by the individuals governing the organisation – usually the board. This means the individuals running the organisation take on personal responsibility and liability. Therefore, unincorporated legal structures would not be a viable option for Explore.
- 2.24 We have also not outlined any of the more commercial legal structures, such as **limited liability partnerships (LLPs), companies limited by shares** or **Co-operative Societies**. In our experience, many local authorities would find it difficult to approve a transfer of a local authority service to these more commercial legal structures where members/individuals can receive dividends. Further, in this case you

have indicated that it is likely the Council would like to make the transfer to a charitable entity – which makes transferring to a more commercial entity unlikely.

- 2.25 As above, we have focused in this paper on two charitable legal structures – a charitable Bencom and a charitable company limited by guarantee. We have listed some of the advantages and disadvantages of charitable status at Appendix 2 of this note so you can understand why charitable structures are attractive to the Council/Service/its members.

3. Industrial and Provident Community Benefit Society (Bencom)

What is a Bencom?

- 3.1 A Community Benefit Society (Bencom) is a body corporate with limited liability registered under the Co-operative and Community Benefit Societies and Credit Unions Act 1965 (CCBSCUA 1965). It is a type of industrial and provident society. If the Bencom has objects that are charitable in law (see paragraph 4.2 below), then it will be classed as an exempt charity and should be eligible for charitable tax breaks, if accepted as a charity by HMRC.

- 3.2 A Bencom is set up to benefit the broader community, rather than just its members. The CCBSCUA 1965 requires a special reason for wanting to register as a Bencom rather than a company, which in practice means including a standard constitutional provision:

- requiring that benefits will not be returned to its members;
- demonstrating that business will be conducted for the benefit of the community; and
- typically including a one member one vote principle, regardless of shareholding.

- 3.3 While Bencoms can pay interest on member share capital, they cannot distribute surpluses to members.

What type of constitution should a Bencom have?

- 3.4 Bencoms' constitutions are called "Rules" which must include the matters set out in schedule 1 of CCBSCUA 1965. It is cheapest and easiest to adopt model rules without amendment. There are several sponsoring bodies that have model Rules for Bencoms accessible on their websites.

Registering a Bencom

- 3.5 To establish a Bencom, you need to submit to the newly established Financial Conduct Authority (FCA) the 'Mutual Societies Application Form', two copies of the Rules and a registration fee. The form is signed by three founder members and the secretary. See: <http://www.fca.org.uk/firms/firm-types/mutual-societies/industrial>]

What are the registration fees?

- 3.6 Registration fees vary from £40 to £950 depending on how closely you base your constitution on the model constitutions provided by sponsoring bodies. The sponsoring body can charge for the use of its model, for example Co-operatives UK would charge around £660 for Explore to use its model Rules. (See: <http://www.uk.coop/advise/modelrules>).
- 3.7 It is unlikely that the proposed governance structure of Explore (as set out in paragraph 1.2 of this paper above) will be scrutinised or questioned by the FCA.
- 3.8 If the Rules and application form are satisfactory, the FCA will issue an acknowledgement of registration which brings the Bencom into existence.
- 3.9 The Bencom will be listed on the Mutuels Register at: <https://mutuals.fsa.gov.uk/Search.aspx>
- 3.10 As the Financial Services Authority (FSA) has now been reorganised into separate entities, and registration of industrial and provident societies has been taken over by the FCA from the beginning of this month, it is difficult to give a reliable estimate of how long the application process will take. [EC looking into likely current timings with FCA and will confirm.]

Ongoing Regulation

- 3.11 Bencoms are required to file accounts and a return annually. Other matters which must be notified to the FCA are charges, changes to rules, change of name and change of registered office. There is an annual fee payable to the FCA by Bencoms ranging from £55 to £425 depending on value of assets.
- 3.12 The FSA was, and the FCA is likely to be, a relatively light touch regulator compared to the Charity Commission. This has obvious advantages, but the FSA also had a reputation for being an inefficient regulator of Bencoms. It remains to be seen if the situation will change under the FCA.

Governance

- 3.13 A Bencom must have a committee and a secretary, and may have other officers if required. The Rules must make provision for their appointment and removal. The FCA does not need to be notified of changes of committee members and officers except in the annual return.

Membership

- 3.14 The Rules must set out terms of admission of members, including any minimum shareholding required. Voluntary and open membership is usual for Bencoms, especially those seeking grant funding or charitable status. We assume that Explore would open its membership to any members of the community.
- 3.15 The one member one vote principle is standard in Bencoms. The Rules will generally give members the right to:

- (a) Attend a general meeting;
- (b) Receive and approve the accounts;
- (c) Amend the rules by special resolution;
- (d) Elect and dismiss the board of directors;
- (e) Approve the interest rate on shares (and the dividend in a co-operative); and
- (f) Appoint and dismiss the auditors.

Do Bencoms need to register with the Charity Commission?

- 3.16 A Bencom can be charitable, if its objects are charitable and if it confers sufficient public benefit (see criteria for charitable status at paragraph 4.2 below).
- 3.17 Charitable Bencoms are classed as exempt charities, regulated by the FCA with their charitable status recognised by HMRC (but see paragraph 3.21 below about HMRC registration for Bencoms). Under the Charities Act 2011 charitable Bencoms lose their exempt status and are required to register with the Charity Commission once their gross income exceeds £100,000, unless the charity falls under the regulation of another regulator (known as the “principal regulator”) - which the Bencom can register with instead of the Charity Commission.
- 3.18 It was expected that by now Bencoms (with gross income over £100,000) would be legally required to register with the Charity Commission, but the Charity Commission is currently not accepting applications from Bencoms. This policy decision has been taken by the Commission on the grounds that Bencoms can pay interest on shares to members, and the Charity Commission does not consider this payment out to shareholders as charitable. Further, the Commission has raised concerns about the fact that Bencoms often have employee controlled boards, which is usually not permitted for registered charities.
- 3.19 Therefore, one of the concerns for Bencom status for Explore is that if and when the Bencom is required to register with the Charity Commission, the Charity Commission may raise issues with the proposed board members (that are likely to include the Chief Executive and an employee director) – see paragraph 4.6 below for the Charity Commission’s attitude to employees on trustee boards.
- 3.20 There are some exempt charities whose principal regulator is Department for Culture Media and Sport (DCMS), such as the British Library, the British Museum and the National Gallery. There is no formal guidance/ruling from the Charity Commission (or the Attorney General) that Bencoms will be granted a separate principal regulator and not required to register with the Charity Commission.

Registering with HMRC

- 3.21 A main advantage of Explore becoming a charitable Bencom (as opposed to a non-charitable Bencom), is that charitable Bencoms can register with HMRC for charitable tax reliefs. Charities, unlike the other legal structures listed at paragraph 2, qualify for a number of tax reliefs including:

- Income tax and corporation tax exemptions/reliefs
- Capital gains tax reliefs
- Charity business rates reliefs (likely to be more generous than the non-charitable not for profit business rates relief)
- Gift aid (donations can be increased by gift aid)
- Inheritance tax reliefs
- Charity stamp duty land tax reliefs

What is the process for registering charitable Bencoms with HMRC?

- 3.22 When HMRC considers applications for charitable status from Bencoms it will look at the governing document of the Bencom and whether it has objects that are wholly and exclusively charitable and otherwise comply with charity law. Applications are looked at on a case-by-case basis. The approach of examiners at HMRC differ, but in our experience HMRC have when considering Bencom applications looked at the charitable objects, the benefits that board members can receive and the dissolution clause of the Bencom (i.e. to check that the assets on a dissolution must pass to another charity).
- 3.23 If Explore does have two employees on the board, HMRC could query this as part of its consideration of the HMRC application as the general rule for charities registered with the Charity Commission is that board members should not be employees of the charity. It is difficult to predict what issues (if any) HMRC would raise with the Rules of Explore and until the Rules have been drafted. However, it is important to note that HMRC *can* raise issues and scrutinise the provisions of the Rules before granting charitable tax status.

4. Charitable company limited by guarantee (CCLG)

What is a charitable company limited by guarantee?

- 4.1 A charitable company limited by guarantee (CCLG) is a company with no share capital (registered at Companies House) that is also registered with the Charity Commission for England and Wales. There are therefore two registration processes: registration with Companies House (that can be completed in 24 hours) and registration with the Charity Commission (that typically takes between 6 weeks to 4 months).
- 4.2 Charities must have objects that are exclusively charitable under the laws of England and Wales (see example charitable objects - http://www.charity-commission.gov.uk/Start_up_a_charity/Guidance_on_registering/Example_objects/exobjhome.aspx) and must satisfy the public benefit test. This means they must benefit the public as widely as possible, for example, making the charity's activities open to as wide a section of the public as possible.

What type of constitution should a CCLG have?

- 4.3 A CCLG will have Articles of Association, like any other company. The key provisions in the Articles of Association that make the company limited by guarantee charitable are as follows:
- Exclusively charitable objects of the CCLG are set out in the Articles. (For example, for Explore, the charitable objects may focus on the advancement of education, advancement of art (particularly literature), recreation and the community/social welfare.)
 - There is a provision limiting the financial benefits that members and trustees can receive.
 - There is a dissolution provision stating that on dissolution the remaining assets of the CCLG will be transferred to another charity.

Registering a CCLG

- 4.4 To establish a CCLG, you need to submit to Companies House the IN01 application to register a company:

http://www.companieshouse.gov.uk/forms/generalForms/IN01_application_to_register_a_company.pdf

Once the company is registered, the charity application form needs to be submitted to the Charity Commission and signed by all of the trustees.

What are the registration fees?

- 4.5 Registration fees vary from £20 to £220 (Companies House fees) depending on whether you submit the application to register the CCLG in hard copy or electronically. The Charity Commission does not charge a fee.
- 4.6 From our experience of registering other public authority “spin out” charities with the Charity Commission, it is likely that during the application process the Charity Commission will raise questions about the Council’s potential influence over the charity through its nominated trustee and the two employees on the trustee board.
- 4.7 It may also question the number of staff who are members. We have registered other similar charities where the local authority has a nominee on the trustee board and where there are up to two employees on the trustee board; but it is important to note that it is within the Charity Commission’s power to ask the CCLG to change the governance structure before registering (if, for example, the Charity Commission does not think there are valid reasons for the employees or the Council nominee to be on the trustee board). We therefore could not guarantee that the chosen governance structure would be accepted by the Charity Commission.
- 4.8 Once the application has been accepted by the Charity Commission and all other questions about the CCLG satisfactorily answered, the Charity Commission will issue an acknowledgement of registration and the charity registration number.

4.9 The CCLG will be listed on the Register of Charities at: <http://www.charitycommission.gov.uk/Showcharity/RegisterOfCharities/RegisterHomePage.aspx?Language=English>

4.10 The registration times with the Charity Commission differ depending on the complexities and officer looking at the application. For this type of CCLG we would estimate that the application process will take between 6 weeks to 3 months from the date of submission, but it might be possible to expedite the application if there is a particular urgency.

Ongoing Regulation

4.11 CCLGs are required to file accounts, a return and a trustee report annually with both Companies House and the Charity Commission.

4.12 If the CCLG wants to change the wording in the provisions in the Articles listed in paragraph 4.3 above, the CCLG will probably first need the consent of the Charity Commission.

Governance

4.13 A CCLG must have members and trustees (although they can be the same people), and may have other officers. The Articles must make provision for their appointment and removal. Companies House and the Charity Commission need to be notified of changes on the trustee board.

Registering with HMRC

4.14 CCLGs must also register with HMRC, although as a charity registered with the Charity Commission it is a more straightforward process than a Bencom application.

5. Comparison of a CCLG compared with a Bencom

The table below summarises the key features of a CCLG compared with a Bencom.

	Bencom (Community Benefit Society)	CCLG (Charitable company limited by guarantee)
Costs to set up and run	£40 - £950 to set up. Slow and cumbersome registration process. EC checking current timings. Annual fee from £55 to £425 depending on value of assets. No additional fees for filing annual returns or accounts.	From £15 to £200 if using incorporation agent. Same day registration possible. Fees for annual return is £15, filing accounts is free.
Transparency	Documents such as annual returns can be obtained but there is a cost attached (usually £12 a document) and can take some time to obtain documents.	Documents can be obtained immediately for minimal fee (usually £1 per document).

Efficiency of Regulator	Can be slow and difficult to speak to anyone.	Both Companies House and the Charity Commission have easily accessible helplines. Documents filed with Companies House appear on the register within 1 week, up to 4 weeks for the Charity Commission. Most documents can be filed with Companies House online. Many details on the charity register can be updated online.
Asset lock?	Yes. This asset lock is unalterable.	Yes
Familiar structure for funders and professionals?	Legal form is less understood by banks, funders and insurers which can lead to questions and delay. It can also be more expensive to obtain appropriate legal/accountancy advice.	Yes
Charitable status?	A charitable Bencom is an exempt charity and can register with HMRC as a charity. An exempt charity, it is not <i>currently</i> required to register with the Charity Commission and therefore does not have a registered charity number. This can be harder to explain to members of the public, funders and professionals.	Registered with and regulated by the Charity Commission with a registered charity number.
Mergers/transfers/ conversions	Streamlined process for amalgamations with and transfers to other societies. An IPS can also convert into a company limited by guarantee.	No special procedures
Can issue withdrawable share capital?	Yes, although members usually own only a nominal amount.	No – a CCLG has no shares
Limit on size of shareholding?	Yes, an individual may hold a maximum of £20,000 withdrawable shares.	As above
Can distribute profits to members in the form of a dividend?	No, but it can pay limited interest on shares.	No
Shareholder democracy	Yes. One vote per member. Members tend to be more involved	One vote per member is standard although members can be given

	in the organisation as customers and volunteers.	different classes of rights
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5.1 To conclude this paper we have identified below the main relevant advantages of establishing a Bencom compared with a CCLG.

Establishment of a Bencom – main advantages in comparison to CCLG

- (a) There is a Council precedent for establishing a charitable bencom for a service transferring out of the Council, as the York Museums Trust is a charitable bencom. The Council therefore may feel more comfortable with this legal structure.
- (b) The Cabinet Report issued on 8 January 2013 identified the Bencom status as the preferred option for the new entity – although we understand other options may not have been fully explored.
- (c) At registration stage, the proposed governance structure of Explore is likely to be more easily accepted by the FCA (the Bencom regulator) than the Charity Commission (the CCLG regulator). However, HMRC could raise questions about the governance structure during the HMRC charity registration process, and if the Bencom needs to register with the Charity Commission in the future, the Charity Commission could also scrutinise the governance structure before accepting Explore for registration.
- (d) The FCA is a more “light-touch” regulator than the Charity Commission and therefore Bencoms currently have more freedom.
- (e) Members can buy equity (shares) in the Bencom, helping the Bencom raise funds -and interest can be paid out on shares attracting members to buy equity.

Establishment of a CCLG – main advantages in comparison to Bencom

- (a) Stakeholders, funders, staff and the public are more likely to understand the registered charity CCLG structure. It can be awkward for Bencoms that they do not have registered charity numbers.
- (b) Banks and commercial partners are more likely to understand the CCLG structure (as they will be comfortable with a type of company).
- (c) The Charity Commission and Companies House are more efficient regulators than the FSA was and have better helplines for immediate advice – it remains to be seen how efficient the FCA will be.
- (d) It is more expensive to register a Bencom than a CCLG and the FCA charges higher annual fees than Companies House/ the Charity Commission.
- (e) The application process to register a CCLG with HMRC, rather than a Bencom, is usually more straightforward as HMRC knows that the charity constitution has already been scrutinised by the Charity Commission

- (f) The regulation of CCLGs is unlikely to change in the foreseeable future, whereas the future for Bencoms is less certain as it is not clear when (if at all) the Charity Commission will require Bencoms to register with the Commission or if a principal regulator will be appointed.

19 April 2013, Bates Wells & Braithwaite London LLP

APPENDIX 1

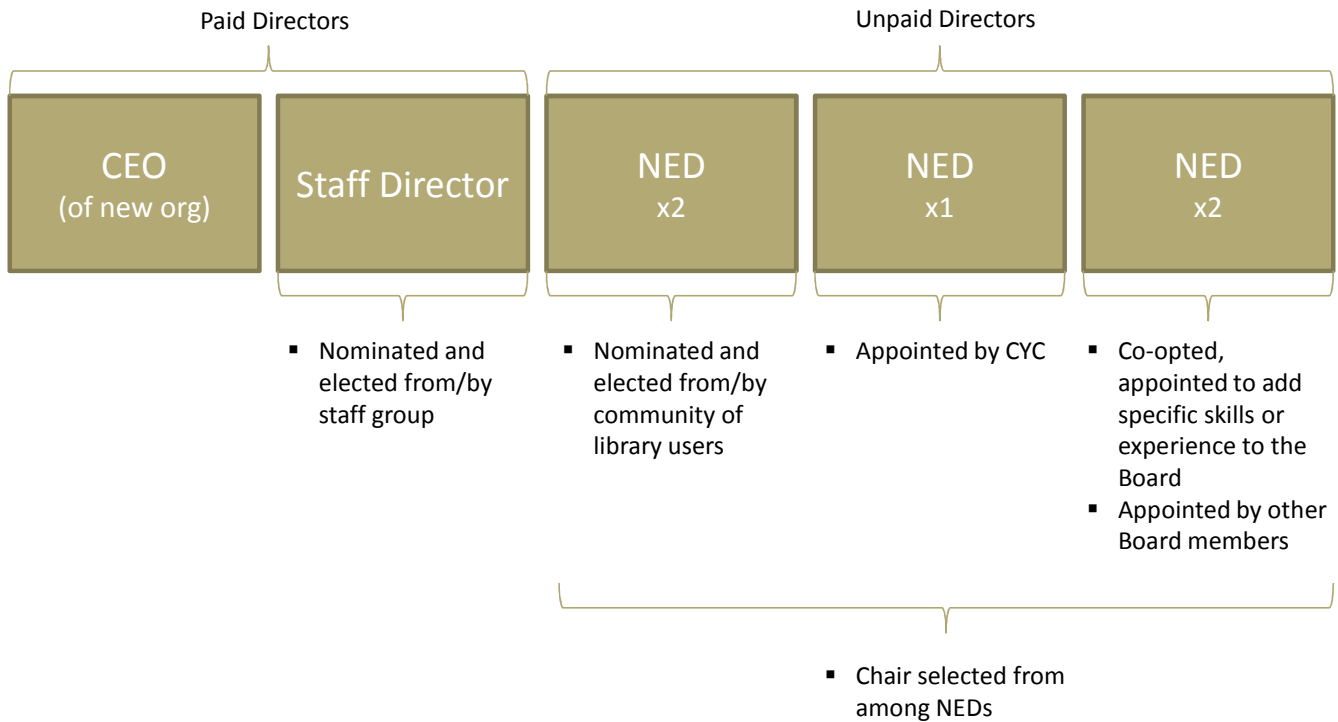
Prepared by Mutual Ventures

Legal Form and Governance Summary

- It was decided that the original advice from CYC Legal Services would be followed. CYC Legal Services advised that the most appropriate model is an Industrial and Provident Society in the form of a **Community Benefit Society with exempt charity status**. Registered with the Financial Conduct Authority (FCA), and regulated by the Department for Culture, Media & Sport (i.e. “the principal regulator”).
- It is proposed that ownership of the new organisation (Explore) is split between the Community (66%) and the Staff (33%), where the Community is defined as a library member.
- Membership will be open to anybody who supports the objects of the society and who is aged 16 and over – staff and the community.
- Staff will be required to opt out if they do not wish to become a member of the society, whereas the Community (library members) will need to opt in. (*Membership of the*

society would be separate to membership of the Library, which would remain free of charge. People would have the choice of belonging to just the library or to the society as well).

- Each member holds one share in the society. These nominal (£1.00) shares do not receive dividends and are cancelled when a member leaves.
- Proposed Board structure shown below:



- Five advisory groups are proposed – (1) Children and Young People’s group, (2) Equality group, (3) Adult Learning group, (4) Staff group, and (5) Service user group. The elected Staff Director would chair the staff group, which would comprise a cross section of staff, and a Non-Exec Director would be selected to chair each of the other advisory groups. The advisory groups would not have any formal decision making power within the new organisation.

APPENDIX 2

Main advantages and disadvantages of charitable status

Advantages

- **Charity tax reliefs** – see paragraph 3.21 of this paper
- **Public recognition** – members of the public widely recognise the charity brand
- **Wider access to funding** - although other types of not for profit entities are eligible for government, trust and foundation and other sources of grant funding, some funders still prefer to grant fund charities
- **The Council (and its Cabinet) may feel more comfortable** transferring the Service to a Charity rather than another type of not for profit entity

Disadvantages

- **Less flexibility** - charities must always act in furtherance of their exclusively charitable objects and for the public benefit. This means they have less flexibility than commercial entities or other types of not for profit structures. (For example, charities cannot directly carry out non charitable trading except through a trading subsidiary)
- **Stronger regulation** - for charities registered with the Charity Commission, the Charity Commission has wide regulatory powers (for example, to investigate and remove trustees)
- **General rule – no employees on board** – for charities registered with the Charity Commission the general rule is that employees cannot be on the trustee board – although exceptions apply
- **Longer registration process** – it usually takes longer to establish a charity than other legal structures