



**COMMUNITY  
INTEREST  
COMPANIES**

**Office of the Regulator of Community  
Interest Companies: Leaflets**

**Information Pack**

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# The Role of the Regulator

The Companies (Audit, Investigations and Community Enterprise) Act 2004 ('the Act') established the Regulator as an independent statutory office-holder appointed by the Secretary of State. The Regulator's appointment was subject to an open public recruitment process monitored by the Office of the Commissioner for Public Appointments.

The first Regulator of Community Interest Companies (CICs) was appointed on 01 April 2005. The Regulator's powers and duties are set out in the Act and Regulations.

The Act requires the Regulator to discharge his functions in accordance with good regulatory practice.

In particular, the Regulator must have regard to:

- The likely impact of his actions on those affected.
- The results of consultation with stakeholders.
- The efficient and economic use of his resources.

The Government has indicated that it expects the Regulator to be "a light touch regulator", who will encourage the development of the CIC "brand" and provide guidance and assistance on matters relating to CICs.

Some of the Regulator's time is spent considering the registration (or conversion) documents for new CICs referred to the Regulator, by the Registrar, to decide whether the companies concerned are eligible to become CICs. The Regulator's decision will be based on examination of the community interest statement and the registration documents, such as, the application form, memorandum and articles of association and the appropriate resolutions, in the case of a conversion. It is for the Regulator to ensure that the purposes of the company and its constitution comply with the Act and Regulations and, in particular to decide whether, it satisfies the community interest test.

The Regulator sees his task as facilitating the formation of CICs; he will not take a bureaucratic approach and will through his office try to resolve any problems informally by e-mail, letter or telephone and is prepared to consider additional material submitted by letter. Provision of material by e-mail or letter cannot, however, be a substitute for the completion of the appropriate forms and documents as only these are placed on the public file. The Regulator and his staff are happy to discuss general questions prior to an application being made, but cannot advise on specific points or prejudge decisions.

A similar approach will be taken to all other matters upon which the Regulator has to decide, such as approval of a change to the objects of a CIC or disposal of assets.

As a matter of good administrative practice, and in order to comply with the statutory obligations, the Regulator will consult those who are about to be subject to his decisions before making them, except where it would be inappropriate to do so. For example, where there is a need to act immediately to safeguard a CIC's assets, consultation might undermine the purpose for which action is to be taken.

In matters that are not specific to particular companies, such as possible changes to the dividend and interest caps, the Regulator will consult stakeholders before taking action.

The light touch approach to regulation does not envisage pro-active supervision of individual CICs by the Regulator.

All CICs are required to file with their accounts an annual CIC report that will be placed on the public register at Companies House and will be copied to the Regulator.

It should not be assumed that the filing of this report will automatically make the Regulator aware of any cause for concern about a CIC. Members and other interested parties may wish to draw any such matters to his attention.

The Regulator will consider the CIC report and any complaints and, where necessary, may make further enquiries and take appropriate action. It may, however, often be possible to resolve issues in discussion with the interested parties.

## Defining a community

The essential feature of a Community Interest Company (CIC) is that its activities are carried on for the benefit of the community and it is important that before creating a CIC you have a clear picture of the community you intend to serve.

### The Community

A community, for CIC purposes, can embrace either the community or population as a whole or a definable sector or group of people either in the UK or elsewhere. The Act provides, that for the purposes of the community interest test, "community" includes a section of the community. The Regulations state that any group of individuals may constitute a community if they share a common characteristic which distinguishes them from other members of the community and a reasonable person might consider that they constitute a section of the community (Regulation 5, as amended by the CIC (Amendment) Regulations 2009).

However, a company which benefits a group which may be clearly defined, but which a reasonable person might not consider to be a genuine section of the community (e.g. "my family", "my friends", or "regular drinkers of ABC beer"), is unlikely to be eligible to be a CIC. In other words, in the Regulator's view, regulation 5 has to be against the overall background of the view which a reasonable person would take of what constituted a section of the community for the purposes of the community interest test.

It is expected that the community will usually be wider than just the members of the CIC. For example, the community of a CIC formed to run a community bus service would include the whole of the population of the area served not just those residents who had invested in the company.

In most cases the community should be easy to define such as:

- The residents of “Oldtown”
- People with learning difficulties
- The elderly
- The young unemployed
- Small scale produce growers in Africa
- The “XYZ” charity
- Sufferers from “ABC” disease
- People wishing to learn to...
- Youth of “Oldtown” needing sports facilities
- Redundant car workers

In other cases the purpose of the CIC will in itself suggest a benefit to the whole community such as:

- Research into environmental pollution
- Preservation of wetlands
- Provision of advice services
- Preservation of language/culture
- Encouragement of sport
- Establishing a museum
- Hire of equipment for short term needs
- Support for community projects

In further examples the community may be the beneficiary of surpluses or profits of trading activities which may not themselves be specifically community benefit activities. Such CICs could have purposes described in terms such as:

- Trading to create a surplus to assist...
- Contracting to provide services and using surpluses from this for the benefit of...

This type of activity where the community benefit may be either from the activity itself or the profits of the activity (or both) are areas where the CIC format could be particularly suitable. CICs could, for example, act as the procurement arm for a group of schools or care centres, who in turn could benefit by participation in dividends as shareholders or donations from profits if they were themselves asset locked bodies.

A CIC must not be too deeply involved in any form of political activity.

You should note that a company can only be eligible to become a CIC if it satisfies the community interest test. A company will not be eligible if any of its activities benefit only the members of a particular body or the employees of a particular employer, without bringing any benefits (directly or indirectly) to a wider community.

If the community, which your proposed CIC is primarily intended to serve, is made up of members of a particular body or employees of a particular employer, you will consider what wider community benefits the proposed CIC can be said to deliver.

## The Community Interest Test

Most ordinary companies, even those that provide benefits to the community, are set up and run mainly for the benefit of their own members and employees. Community Interest Companies (CICs) are different. Their primary purpose is to provide benefits to the community, rather than to the individuals who own, run or work in them.

In the legislation, this core principle is set out in terms of the “community interest test”. A company satisfies the community interest test if a reasonable person might consider that its activities (or proposed activities) are carried on for the benefit of the community.

All companies applying to be registered as CICs must provide the Regulator with evidence that they will satisfy the community interest test. To enable the Regulator to decide whether they will satisfy the test, applicants are required to deliver a community interest statement to the Registrar.

When the Regulator considers whether a company will satisfy the community test, he is taking a view about the likely course of its future activities and what reasonable people might think of them. Once a company has been registered as a CIC, it must continue to satisfy the test for as long as it remains a CIC. The Regulator may take enforcement action against a CIC if he forms the view that it no longer satisfies the test.

In order to determine whether your company satisfies (or will satisfy) the test, you need to consider:

- the purposes for which it is set up;
- the range of activities in which it will engage;
- and who will be seen as benefiting from its activities.

It is not necessary that each activity carried on by the company must in itself be directly beneficial to the community. But it is important that everything that a CIC does should in some sense contribute towards achieving a purpose that is beneficial to the community.

For example, a company whose activities include manufacturing and selling a particular product does not have to show that that product benefits the community – although that might be one way in which it could satisfy the community interest test in relation to these activities. It could equally well satisfy the test by virtue of the fact that the profits from its sales of the product in question are to be devoted to community benefit purposes.

In some cases, it will be necessary to take account of possible damage or harm to the community arising from a CIC's activities. Clearly, an otherwise beneficial activity which a reasonable person might consider to have these consequences for the community or a section of the community (which may or may not be the same community which the CIC aims to benefit) may not satisfy the community interest test.

However, the legislation provides that there are two kinds of activities, which in ordinary circumstances might be considered "beneficial", but which will prevent a company being eligible to be a CIC. These are:

- Political campaigning and activities intended to support political campaigning. This is because the legislation is designed to ensure that the Regulator is not drawn into any political debates by having to reach any sort of view on the merits of particular political aims or programmes, and;
- Activities which a reasonable person might consider to benefit only the members of a particular body or the employees of a particular employer. This is a crucial distinction between CICs and most "ordinary" companies.

Please note that there is no prohibition on a CIC doing things that benefit members of a particular body (e.g. its own shareholders), or its own employees (or the employees of another employer). For example, some CICs would be unable to provide much in the way of benefits to the community if they did not also pay salaries to their employees and directors; and some CICs will be better able to realise their community benefit objectives if they can attract investors by paying dividends to their shareholders.

However, a company will be disqualified from satisfying the community interest test if it engages in activities that a reasonable person might consider benefit, for example, its members or employees without contributing towards any wider community benefit. A company which is established primarily to benefit its members or employees rather than

external stakeholders will have to show that it will deliver some wider benefit if it is to be eligible for CIC status. These wider benefits can arise in several ways as the following examples illustrate:

- A company formed to provide its members with a service which meets a pressing social need or to provide jobs to disadvantaged people, who would otherwise be unlikely to find employment could satisfy the test because its activities would benefit the wider community as well as its members or employees.
- A sports club for employees of a business may only satisfy the test if it provides a wider community benefit, for example, by making its facilities available to the local community or providing training facilities not otherwise available in the area.
- A company formed by the employees of a business solely for their own profit, such as a bulk purchasing discount scheme would not satisfy the test.
- If, however, the sports club ran a purchasing scheme as an incidental activity which contributed to the community objectives of the club this may not affect its eligibility to be a CIC.

## The Asset Lock

The Asset Lock is a fundamental feature of Community Interest Companies (CICs). It is important that you understand the concept before setting up a CIC as it has permanent long-term consequences.

“Asset Lock” is a general term used to cover all the provisions designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.

### A transfer of assets must satisfy certain requirements

This means that, subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must satisfy one of the following requirements:

- It is made for full consideration (i.e. at market value) so that the CIC retains the value of the assets transferred;
- It is made to another asset-locked body (a CIC or charity, a permitted registered society or non-UK based equivalent) which is specified in the CIC’s articles of association;
- It is made to another asset locked body with the consent of the Regulator; or
- It is otherwise made for the benefit of the community.

Provision to this effect, as prescribed in the Regulations, must be included in a CIC's articles of association. CICs are permitted to adopt asset lock rules that impose more stringent requirements, provided they also include these basic provisions.

## **What is a 'specified' asset-locked body?**

An asset-locked body means a community interest company, a charity, a permitted registered or a body established outside the United Kingdom that is the equivalent to those persons.

It is important to consider whether you want to specify an asset-locked body as a possible recipient of your CIC's assets (for less than full consideration) in the CIC's articles.

Such a nomination may prove particularly important in the event of the CIC being wound up or dissolved when it is not insolvent, as, in the absence of a nomination, the Regulator will be in consultation with the directors of the CIC to decide the destination of any remaining assets.

In addition, the Regulator will have to approve any transfers (for less than full consideration) to asset-locked bodies which are not nominated in the community interest company's (CIC) articles of association.

## **Restrictions on the return assets to members**

With only very limited exceptions such as the payment of dividends and the return of paid up capital on liquidation, a CIC's assets cannot be returned to its members unless they are themselves asset locked bodies. See the guidance available on our website with regard to the payment of dividends and the cap on dividends which is an important feature of the Asset Lock that applies to dividends paid to non-asset locked bodies.

## **Assets can be used as collateral**

Normal trading conditions apply. A CIC is a limited company with all the usual duties and obligations of a company. The Asset Lock should not be seen as a bar to the CIC using its assets for normal trading, or other business activities, and meeting its financial obligations.

For example, a CIC may take on a commercial venture with the purpose of generating profits to support its community benefit objects. If the venture fails and makes losses the CIC must still meet its contractual obligations in regard to the venture even if this means depleting its assets or selling some of them to meet its debts.

## **Interpretation of transfer of assets**

The transfer of assets at less than market value must be given a wide interpretation and it should always be remembered that cash is often an organisation's main asset. Payments for services etc must represent full market value. This means, for example, that payments

to staff and directors must not be disproportionately high in relation to their abilities and the services they perform. Similarly management, or other service charges (particularly if provided by associates who are not asset locked bodies), must represent value for money.

## **The community interest test and the asset lock**

There is a clear inter-relationship between the asset lock and the Community Interest Test in that the test may not be seen to be met if a reasonable person might consider that the activities of the CIC are being carried on for the benefit of the company's directors, employees or service providers rather than for the benefit of the community.

## **A Community Interest Company (CIC) providing a service at less than the market rate**

There is no reason why a CIC should not be run to provide a service (to other CICs, charities etc), which is delivered at less than the going open market rate providing it covers its outgoings and does not infringe other legal considerations, such as, wrongful trading or unfair competition.

# **The Dividend Cap**

The Dividend Cap strikes a balance between encouraging people to invest in Community Interest Companies (CICs) and the principle that the assets and profits of a CIC should be devoted to the benefit of the community. This helps to ensure that the dividends are not disproportionate to the amount invested and the profits made by the company.

## **The three elements to the dividend cap**

The Cap has three elements:

The maximum dividend per share limits the amount of dividend that can be paid on any given share. The limit for shares in issue between 1 July 2005 and 5 April 2010 is 5% above the Bank of England base lending rate of the paid-up value of a share. The limit for shares issued on or after 6 April 2010 is 20% of the paid-up value of a share.

- The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is 5 years.

## Amount of first caps

The CIC Regulations 2005 set the first caps and these rates may be varied from time to time by the CIC Regulator after consultation and with the approval of the Secretary of State.

Shares in issue between	Maximum Share Dividend Cap
<b>1 July 2005 to 5 April 2010 (set by the CIC Regulations)</b>	5% points higher than the Bank of England's base lending rate of the paid up value of share
<b>6 April 2010 and onwards (set by the CIC Regulator)</b>	20% of the paid-up value of a share in a relevant company
Aggregate Dividend Cap	Content and purpose
<b>1 July 2005 and onwards</b>	35% of distributable profits

The Bank of England's base lending rate (also referred to as the Repo Rate) is available from its [website](#), which also gives details of what the rate has been in the past.

It should be noted that these caps set maximums. They should not be taken as in any sense suggesting that those who invest in community interest companies are entitled to a particular rate of return on their investment. The caps should also not be seen as limiting companies' discretion as to whether or not to pay dividends at all, or whether to pay a dividend in any given year. Finally, there is no reason why a company should not restrict distributions to lower amounts than would be permitted under the caps in its articles, or share prospectus, or offer documents. If the company has, for example, issued fixed rate preference shares, the dividend on those shares will be subject to the caps but if the caps allow a higher rate this does not entitle the shareholders to receive that higher rate.

## Maximum dividend explained

The maximum dividend per share is fixed by reference to the "share dividend cap" in force at the time that the share was issued, or, if the share was already in existence on the date the company became a community interest company (CIC), the cap applicable on that date.

The share dividend cap is expressed as a percentage of the paid up value of the share (the rate). The paid up value of the share is so much of the share's nominal value as has been paid up and any premium paid on that share to the company. Thus if the company issued £1 shares fully paid at a premium of £2.50 a share the paid up value of those shares would be £3.50. This should not be confused with market value; if, for instance, the same share were purchased from an existing shareholder for £5 the paid up value would still remain at £3.50.

The rate for a particular share is fixed for the life of that share and will not change if the rate generally is changed. It can, however, fluctuate if the Bank of England base lending rate changes and it is referenced to that rate.

In respect of shares issued between 1 July 2005 and 5 April 2010 if, for example, the agreement is made when the Bank of England Base Rate at the time is 3%, the cap will be 8%. If the Bank of England Base Rate subsequently rises to 5%, the rate for that debt will rise to 10%.

In respect of shares issued between 1 July 2005 and 5 April 2010 if, for example, the agreement is made when the Bank of England Base Rate at the time is 3%, the cap will be 8%. If the Bank of England Base Rate subsequently rises to 5%, the rate for that debt will rise to 10%.

Where the rate is subject to this kind of fluctuation, the rate applicable to any dividend payment is that in force on the first day of the financial year in which the dividend is declared. This may not be the same as the rate when the dividend is actually declared. For example, if the financial year begins on 1 April 2009 when the rate is 7%, but the dividend is paid in October 2009 when the rate is 7.25% because the Bank of England has put its Base Rate up by 0.25% in the meantime.

If more than one dividend is declared in a financial year the total of all such dividends must not exceed the maximum dividend per share. For example, if the share dividend cap is 7% on the first day of the financial year the maximum amount of dividend that may be declared over the course of that financial year on a fully paid up £1 share is 7p. This may be paid either as a single dividend of 7p, or for example, an interim dividend of 3p and a subsequent final dividend of 4p.

## Maximum aggregate dividend explained

This element of the Cap is calculated by reference to the aggregate dividend cap in force at the first day of the financial year for which the dividend is declared and is a proportion of the company's distributable profits for that year. Unlike the maximum dividend per share therefore, where the amount payable is fixed for the life of the particular share, the amount of the maximum aggregate dividend will vary from year to year in line with the distributable profits available.

For example if the cap is fixed at 25% and the distributable profits for the year are £2,000, the maximum aggregate dividend for all the company's shares would be  $£2,000 \times 25\% = £500$ .

However, for any particular share the dividend must not exceed the maximum dividend per share. So, for example, if a company issued 5000 fully paid shares, each with a value of £1, but the maximum dividend per share is 9%, the company will not be able to pay a dividend per share of more than  $£1 \times 9\% = 9p$  per share. If 5000 shares are issued  $5000 \times 9p = £450$  in total, £50 short of the maximum aggregate dividend.

## Carrying forward unused dividend capacity explained

The unused dividend capacity is the amount that could have been paid on shares in a financial year but was not paid. For example if a company had £30,000 £1 shares fully paid and the dividend cap for the shares was 10% the maximum aggregate dividend would be 10p per share, i.e. a total of £3,000 (providing the maximum aggregate dividend was at least £3,000). If the company only declared a dividend of 6p a share the unused capacity would be 4p a share or £1,200.

This unused capacity can be carried forward to subsequent financial years so that in year 2 the company could declare a dividend of up to 14p per share providing the maximum aggregate dividend was at least £4,200. The carrying forward of unused dividend capacity therefore allows a company to pay a larger dividend per share than it otherwise would be able to pay, but does not allow it to pay a larger aggregate dividend than the maximum aggregate dividend for the relevant year.

The ability to carry forward unused dividend capacity is limited to four years i.e. if the unused capacity arising in year 1 is not used by year 5 it ceases to be available for distribution.

## Performance related interest cap

Subject to its articles community interest companies (CICs) have the same borrowing powers as any other company and generally will be able to borrow and pay normal commercial rates of interest to lenders. This chapter is not concerned with normal lending of this type but with the somewhat rare circumstances where the interest payable on debts or debentures is linked to the performance of the CIC. Such debt is regarded as similar to equity shares (it is sometimes referred to as “debt with equity characteristics”) and the ability to pay uncapped interest on such debt would circumvent the Dividend Cap.

The Act and Regulations provide that payment of such performance related interest should be subject to a cap. The cap is expressed in terms of a percentage rate on the average amount outstanding on any given loan, or debenture (debt). It will be the rate in force at the date the agreement for payment of the interest was made, or, for existing debt, the date the company became a CIC. The rate for a particular debt is fixed for the life of that debt and will not change if the rate generally is changed. If referenced to the Bank of England rate it can, however, fluctuate if the Bank of England rate changes (Bank of England base lending rate plus a fixed percentage).

## Amount of first cap

The Regulations set the first caps and these rates may be varied from time to time by the Regulator after consultation and with the approval of the Secretary of State.

Agreements made between	Interest Cap:
<b>1 July 2005 to 5 April 2010 (set by the Regulations)</b>	4% points higher than the Bank of England's base lending rate of the average amount of a community interest company's debt, or sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations 2005)
<b>6 April 2010 and onwards (set by the Regulator)</b>	10% of the average amount of a community interest company's debt, or sum outstanding under a debenture issued by it, during the 12 month period immediately preceding the date on which the interest on that debt or debenture becomes due (determined in accordance with Schedule 4 of the Regulations 2005)

If, for example, the agreement was made sometime between the 1 July 2005 and 5 April 2010 and the Bank of England Base Rate on the first day of the financial year in which the interest is due is 3%, the cap will be 7%. If the relevant Bank of England Base Rate in a subsequent year rises to 5%, the rate for that debt will rise to 9%.

The rate applicable to any interest payment is that in force on the first day of the financial year in which the interest is due and the amount is calculated on the average amount of the debt, as defined in the Regulations, in the 12 months ending on the day before the payment is due.

If, for example, the company borrowed £100,000, the interest was agreed at 10% of the company turnover, the debt remained at £100,000 all year and the turnover was £130,000 the lender would be entitled under the agreement to £13,000 interest. If, however, the interest cap was 8% the interest payment would be restricted to £8,000.

It should be noted that if the contractual rate is lower than the interest cap rate this does not entitle the lender to receive the higher cap rate.

## Redemption and repurchase of shares and reduction of capital

A company with a share capital may, subject to its constitution and compliance with company law, redeem shares, purchase its own shares or reduce its share capital. If your community interest company (CIC) is considering doing any of these things, you should seek professional advice. This is a complex area of law for any company and is beyond the scope of this guidance. This chapter concentrates on the additional rules that apply to CICs in this area.

In many circumstances, redemption and repurchase of shares, or reduction of share capital, is in effect a distribution of assets to members particularly where the member receives a premium over the paid up value of the shares. CICs are subject to additional rules in relation to such operations because if they were able, for example, to reduce their share capital without restriction, this could undermine the asset lock. CIC legislation therefore contains a number of provisions to prevent this.

## Redemption and purchase of shares

CIC legislation prevents a CIC from distributing its assets through the redemption or purchase of its own shares unless the payments are set at, or below, the paid up value of the shares. This supplements the asset lock provisions in the articles of association of a community interest company.

A company must have the necessary powers to issue redeemable shares, or to purchase its own shares, in its articles. Additionally, the articles of association must comply with the Companies Act 2006 and the CIC Regulations 2005 with regard to such distributions.

The amount paid must not exceed the paid up value of the shares, that is, the amount of the nominal value paid up together with any premium paid to the company. Please note that redeemable shares must be fully paid on redemption.

The Companies Act 2006 contains detailed rules (which are different for public and private companies) as to the funds that may be used for the redemption.

When the shares have been redeemed they are cancelled and the issued share capital is reduced by their nominal value.

## Reduction of capital

CIC legislation prevents a company from distributing its assets by reducing its share capital, unless it does so:

- By reducing part of the value of shares that is not paid up, or
- By paying out more than the paid up value of the shares.

The company must have the necessary powers to reduce its capital in its articles. Additionally, the articles must comply with the Companies Act 2006 and the CIC Regulations 2005 with regard to such distributions.

## Distribution of assets to members by way of reduction of capital

A CIC may not distribute assets to members by way of reduction of capital unless:

- The reduction is made by extinguishing or reducing the liability of any of the members on any of the company's shares in respect of share capital not paid up; or
- The amount to be paid by the company to members in paying off paid up share capital does not exceed the paid up value of their respective shares.

# Community Interest Companies (CICs) and Charities

## Differences between charities and CICs

Charities must be established exclusively for charitable purposes: community interest companies (CICs) can be established for any lawful purpose, as long as their activities are carried on for the benefit of the community

Charities have certain tax advantages that CICs do not have. In return for those advantages, charities are subject to more onerous regulation than CICs

The CIC legal form was specifically designed to provide a purpose-built legal framework and a "brand" identity for social enterprises that want to adopt the limited company form.

CICs are free to operate more commercially than charities (e.g. CICs limited by shares can pay dividends to individual shareholders, subject to a cap), but stakeholders in CICs will still have the assurance of community benefit provided by the asset lock and transparency about their activities through the community interest report.

A charity may, however, own a CIC and the CIC is permitted to pass assets to the charity. This for example enables a CIC to run a charity shop and pass all the profits to the charity that owns it.

## Why would an organisation want to be a CIC instead of a charity?

There is no doubt that charitable status is exactly right for those who wish to further charitable objectives and it is likely that many organisations operating for the public benefit (and who are eligible for charity status) will choose to be charities, not least for the fiscal advantages.

The sort of people who will want to set up a CIC will typically be entrepreneurs who want to do good in a form other than charity.

This may be because:

1. They are looking to work for community benefit with the relative freedom of the non-charitable company form and to be able to identify and adapt to circumstances, but with a clear assurance of not-for-profit distribution status.
2. Members of the board of a charity may only be paid where the constitution contains such a power and it can be considered to be in the best interests of the charity. It means that, in general, the founder of a social enterprise who wishes to be paid cannot be on the board and must give up strategic control of the organisation to a volunteer board, which is often unacceptable.
3. The definition of community interest that applies to CICs is wider than the public interest test for charity. CICs are specifically identified with social enterprise. Some organisations may feel that consequently this is a more suitable option than charitable status.

## **Charities converting to Community Interest Company (CIC) status or vice versa**

### **Conversion of a charity to a CIC in England, Scotland and Wales**

CIC legislation specifically excludes a company from being both a Community Interest Company (CIC) and a Charity. It is possible for a CIC to have wholly charitable purposes, but it would not be entitled to charitable status.

A charitable company registered in England, Wales or Scotland may convert to a CIC with the consent of the Charity Commission. In so doing it will lose its charitable status, including tax advantages.

### **Conversion of a charity in Northern Ireland to a CIC**

Currently, CIC legislation prohibits the conversion of a Northern Ireland charity to a CIC. It is expected that regulations will be considered at a later date to allow this.

### **CIC converting to a charity**

A CIC may convert to a charity registered in England, Wales, Scotland or Northern Ireland in which case it would cease to be a CIC. It would then be fully subject to the charity regulatory regime.

## A CIC may pass its assets and profits to a charity

A CIC may pass its assets and profits to a charity as they are both asset-locked bodies and may nominate a charity to receive its surplus assets if the CIC is liquidated or dissolved.

### Some points to consider

If you are considering converting from a charity to a CIC, or vice versa, you should consider carefully the advantages of doing so. Some of the points you will need to consider include:

- Tax implications
- The attitude of funding bodies
- The flexibility of the respective regulatory regimes
- Management and employment structures
- Whether the community interest test for community interest companies (CICs) is more appropriate to your purposes than the public interest test applied to charities
- Whether the ability of CICs to pay directors and (in some cases) dividends would help you to attract the right management and investment
- The fact that at the point of conversion the CIC will be under a duty to apply for the registration of a charitable trust to manage the charitable company's property (other than property representing subscribed capital, in the case of a company limited by shares). This means that the charitable property before conversion cannot be transferred to the CIC: it must be held by a charitable trust. The trust is subject to regulatory action under the Charities Act in just the same way as any other charity would be.
- Which type of CIC is appropriate for your purpose i.e. private limited by shares or guarantee or a public limited company.

# Converting a Registered Society to a Community Interest Company (CIC)

## Background

There are no provisions in the CIC Legislation dealing with a Registered Society converting to a Community Interest Company (CIC). It is, therefore, a two-part process.

The Registered Society converts first to an 'ordinary' company and then from the 'ordinary' company to a CIC.

The conversion, from a Registered Society to an 'ordinary' company, does not cause any interruption to the company's operations, neither does converting from a 'normal' company to a CIC. Therefore, a conversion will mean that the assets are automatically transferred.

Once the Registered Society has been converted to being an 'ordinary' company, it is subject to the Companies Act, so any charges which require a registration, will need to be registered.

## Eligibility

To be eligible to be a community interest company a Registered Society must, in the opinion of the Regulator, satisfy the community interest test. The test is whether a reasonable person might consider that the company's activities are being carried on for the benefit of the community. A company must continue to satisfy the test so long as it remains a community interest company.

## The Process

To convert from a Registered Society to a 'normal' company and then from a 'normal' company to a community interest company the society will need to:

1. If registered in England, Wales or Scotland send to the Financial Conduct Authority an application for registration of a special resolution for the conversion of a Registered Society to a company. If registered in Northern Ireland send a copy of the resolution to convert from a Registered Society to a company to the Registrar of Registered Societies.
2. To register the company you are required to deliver to Companies House the following completed documents, with a fee:
  - Memorandum of association

- A printed copy of the articles of association that comply with the requirements imposed by the Companies Act and the CIC legislation. Please note that a CIC cannot rely on the default articles under the Companies Act.
- A form IN01. This shows details of the company's proposed name; whether limited by shares or guarantee public or private; the first directors (and secretary if applicable); the intended situation of registered office; a statement of compliance etc.
- A form CIC36. This shows the company's community interest statement. The purpose of the community interest statement is to confirm that the company will provide benefit to the community. It does this by describing its intended activities who they will help and how.
- Form CIC 36 continuation sheets (use only if needed).
- A Cheque for £139 made payable to "Companies House"

The Registrar of Companies will pass copies of these documents to the Regulator to consider whether the company is eligible to form as a CIC. If eligible and if the documents are acceptable to the Registrar of Companies the documents will be placed on the public record and a certificate of incorporation will be issued. The company by virtue of the issue of the new certificate of incorporation becomes a community interest company, and the changes in the company's name and articles take effect.

## Tax considerations

Community Interest Companies (CICs) will not receive tax breaks from the Inland Revenue by virtue of their legal status. The payment of corporation tax is the responsibility of individual companies, and appropriate professional advice should be sought when considering what your business's tax liabilities are, and how it might be structured in a more tax-efficient way.

It should also be noted that a CIC cannot apply to Inland Revenue for Gift Aid status.

Deductions for tax can often be made against capital expenses and against some of the costs of running a business, such as training. In some circumstances local government may provide discretionary rate relief to social enterprises.

A CIC that donates its surpluses to a charity will be able to deduct the amount of any such donations as a 'charge' when working out its profits for corporation tax purposes. This may be of particular interest to those CICs which are set up as 'trading arms' of charities.

In terms of the cost of raising finance, loan finance will sometimes be more tax efficient for a company than equity investment. This may influence the debt and equity levels a CIC chooses.

There is no general exemption from VAT for social enterprises that undertake trading activities. VAT is a tax on turnover, and is based on the nature of the goods or services supplied. Enterprises operating without a profit motive are still liable to pay VAT, however, those engaged in provision of education, health or welfare may find exemptions. Further detail can be found on the HM Revenue and Customs.

## Sources of Finance

A Community Interest Companies (CICs) principal source of financing will usually be its trading income. In this way, users of goods and services provided by a CIC will be investing in the ongoing sustainability of the organisation. Cash reserves built up out of profits are available for the benefit of the community or reinvestment in the business.

Grants may be available dependent on the expected activities and impact of a CIC's work. Grants are usually targeted at specific projects or for one off capital purchases. Some grant-makers may provide start-up or running costs, or give funds for investment in property and equipment, or for research and development or training.

Although grants have the clear advantage of being non-repayable, conditions attached to them designed to ensure that the money is used for the purposes intended may limit the capacity of an organisation to operate and expand or leverage in commercial finance (for example, some grant-making bodies will not lend to companies limited by shares which have the potential to pay dividends). The dependence on social impact, rather than ability to repay, the risk of donors changing priorities, their short-term nature and payment in arrears often result in grants inhibiting businesses from operating on an effective commercial basis.

Asset based lending is a flexible form of finance which allows businesses to secure funding against debtors (via invoice discounting or factoring), stock, plant and machinery and property. It can be particularly useful to fund seasonal stocking requirements, or to provide increased short-term leverage.

### Employee share ownership schemes

Employees may like to invest in shares to take ownership of a business. There are certain tax concessions to facilitate this however, there is also a risk for employees: if they are asked to invest in their employer only to find that if the business becomes insolvent they have lost their savings as well as their job.

### Charges on Assets

CICs are governed by company law. Where permitted by its constitution, a company can mortgage its assets to a lender in a wider and more flexible way than an unincorporated association, partnership or sole trader can. A mortgage by a company (usually called a charge) over land, vehicles and other property has to be registered at Companies House or within 21 days of its creation.

Companies and CICs can give a 'floating charge' which applies to assets which fluctuate e.g. stock or debtors. The floating charge hangs like a net above the assets charged. At the moment the charge is triggered or 'crystallises', the net drops and covers all the charged assets at that moment. The floating charge is only triggered when certain conditions set out in the terms of the charge or loan facility under which the charge was given take effect.

Borrowing may entail providing debt covenants to lenders restricting the use of assets financed by the loan, dividend payments and further borrowing. Such covenants restrict the flexibility of the borrower and need careful consideration, particularly where community assets are at risk should loans not be repayable.

## Lenders to the Third Sector

The appropriate type and source of finance is always dependent on a company's circumstances and we recommend that professional advice be taken. The high street banks are the most significant overall providers of funding and financial services to small and medium-sized enterprises. Most have dedicated teams supporting social / community enterprises.

Regional social enterprise support agencies can put you in touch with appropriate finance providers operating below the national level.

Community Development Finance Institutions (CDFIs) have been established expressly to support social enterprises, and operate in many different parts of the country, offering a variety of services, including loans. The government provides relief to tax-paying investors choosing to invest in CDFIs 5% of their investment per annum, up to 25%.

For more information please see "Financing CICs" chapter 7 of our guidance available on our [website](#).

# Forming a new Community Interest Company (CIC)

Setting up a company brings many obligations. Before proceeding you are recommended to take professional legal, or accountancy, advice on whether a limited company, in the form of a community interest company (CIC), is the best way to run your enterprise.

The Companies House booklet GP1 "Incorporation and Names" provides information on how to form a new company. The basic procedure is the same for a CIC as for any other company but applicants are required to submit an additional form CIC36.

To form a new CIC you need to deliver the following documents to the appropriate Registrar of Companies for England and Wales, Scotland, or Northern Ireland:

- Memorandum of association

- A printed copy of the articles of association that comply with the requirements imposed by the Companies Act 2006 and CIC legislation, Please note that a CIC cannot rely on the default articles under section 20 of the Companies Act 2006.
- Form IN01. This gives details of the company's proposed name; whether limited by shares or guarantee public or private; the first directors (and secretary if applicable), the intended situation of registered office; a statement of compliance etc.
- A form CIC36. This contains the company's community interest statement. The purpose of the community interest statement is to confirm that the company will provide benefit to the community. It does this by describing its intended activities who they will help and how.
- A cheque for £139 made payable to "Companies House"

Where to obtain forms:

- Forms IN01, CIC36 and model memorandum and articles of association, including explanatory notes, can be obtained free of charge from the Regulator's website.
- They are also available from law stationers and company registration agents.

The Registrar of Companies cannot incorporate a company as a CIC until the Regulator decides that it is eligible to be a CIC and notifies the Registrar of this decision.

The premium same day registration service, therefore, is not available for a CIC. However, every effort will be made to keep the registration time to a minimum, subject to the Regulator being satisfied as to the company's eligibility to be a CIC.

## Converting an existing company to a Community Interest Company (CIC)

To convert an existing company to a community interest company (CIC) you need to deliver the following documents to the Registrar of Companies for England and Wales, Scotland, or Northern Ireland:

- A copy of the special resolutions:
- That the company should become a community interest company.
- To alter the articles of association so that they conform to the requirements of CIC legislation.

- To change the name of the company to one of the CIC designations. There is no need to invent a new name unless you want to; a simple change from “Ltd” to “CIC” will be enough. For more information see Chapter 2.8 of our guidance and Companies House booklet GP1 “Incorporation and Names”.
- A printed copy of the articles of the company as altered by the special resolutions.
- A form CIC37. This contains the community interest statement. The purpose of the community interest statement is to confirm that the company will provide benefit to the community. It does this by describing its intended activities who they will help and how. The link will take you to a copy of the form and an example of a completed form.
- Form NM01. Notice of change of name by resolution.
- A fee for £45 payable to ‘Companies House’

Where to obtain forms:

- Form CIC37, model resolutions, model articles of association, including explanatory notes and form NM01 can be obtained free of charge from the Regulator’s website.

The Registrar of Companies cannot incorporate a company as a CIC until the Regulator of Community Interest Companies decides that it is eligible to be a CIC and notifies the Registrar of this decision.

The premium same day registration service, therefore, is not available for a CIC. However, every effort will be made to keep the registration time to a minimum, subject to the Regulator being satisfied as to the company’s eligibility to be a CIC.

The Companies House booklet GP3 “Life of a company - Part 2 Event Driven Requirements GP3” explains the requirements for passing resolutions. Detailed procedures for holding meetings of members and passing resolutions will be included in the existing Articles of the company. Briefly, to pass a special resolution 21 days notice must be given to the members and a majority of three fourths of members voting at the meeting is required.

The resolutions must be printed or be in some other form approved by the Registrar of Companies and must be delivered to the appropriate Registrar for England & Wales, Scotland or Northern Ireland together with a reprinted memorandum and articles of association incorporating the changes made by the resolutions.

It is possible (even if the necessary special resolutions are passed) that some dissenting members may be sufficiently aggrieved at the decision to convert to a CIC that they will take legal action. This could, for example, be on the grounds that they have been unfairly prejudiced as a result of the reduction in their rights to dividends or other distributions resulting from conversion to CIC status. Depending on the view taken by the Court, such action could undermine the conversion project. It may therefore be useful to informally

canvas member's views on the conversion, or take legal advice, before incurring the expense of the formal process.

The possibility of legal actions being taken by minority shareholders also has some specific consequences for the timing of the conversion process, which are relevant in all cases. Unless a company's articles specifically restrict the objects of the company its objects are unrestricted. The statement of the company's objects means the purposes for which it has been formed. In some cases these are very detailed; in other cases, they are drafted in very general terms (e.g. "to operate as a general commercial company").

CICs are not required to adopt any particular provisions in the objects clause of their Articles, but when converting an existing company to a CIC, you may wish to change its objects in some way, particularly if the company has not previously operated as a social enterprise.

In order to protect the interests of minority shareholders (in the case of a company limited by shares) or members (in the case of a company limited by guarantee), where special resolutions have been passed or made with the view to the company becoming a community interest company, members or shareholders have the right to apply to the Court within 28 days after the date of the on which the resolutions were passed or made for the special resolutions to be cancelled. If such an application is made to the Court, the special resolution(s) do not take effect except in so far as the Court confirms it.

The time for forwarding the resolutions to the Registrar varies as follows:

- Where no application has been made to the court for the cancellation of the special resolution(s) because there was not the required number of dissenting members, within 15 days after the passing or making of the resolutions.
- Where no application has been made to the court for the cancellation of the special resolution(s) the end of the period for making such applications i.e. not earlier than 29 days or later than 44 days of the passing or making of the resolutions.
- Where an application is made to the Court, not later than 15 days after the date on which the Court determines the application, or such later date as the Court may order.

All the resolutions and other documents must be submitted to the Registrar of Companies at the same time together with the appropriate fees.

The changes take effect on the date that the Registrar records the resolutions. The Registrar of Companies will also issue a new certificate of incorporation stating that the company is a CIC.

It should be noted that the issue of a new certificate of incorporation does not have any effect on the made-up date for the company's annual return or the company's accounting reference date. As the company's CIC Report is filed with the annual accounts a CIC Report is required for the accounting period in which the conversion is made. If you are considering converting late in an accounting period you may wish to defer conversion rather than to have to prepare a CIC Report covering a very short period.

All copies of the memorandum and articles of association issued by the company after the resolutions take effect must be in the revised form submitted to the Registrar of Companies.

Converting a company to a CIC brings new constraints and obligations. You are recommended to take professional legal or accountancy advice on whether a CIC, is the best way to run your enterprise before proceeding with the conversion of your company.

## Community Interest Company (CIC) Fees

The fees below are payable by CICs on delivery of the documents relating to the listed events. A cheque, for the amount in the “Total” column, should be delivered with the documents to the Registrar of Companies. The cheque should be made payable to “Companies House”.

EVENT	COMPANIES HOUSE FEE (£)	REGULATORY'S FEE (£)	TOTAL FEE (£)	NOTE
Online Incorporation as a CIC	100	15	115	
Postal Incorporation as a CIC	124	15	139	
Conversion of company to a CIC	30	15	45	1
Conversion including a change of status (re-registration)	124	15	139	2
Change of status of existing CIC (re-registration)	124	None	124	3
Online change of name	20	None	20	
Postal change of name	30	None	30	
Confirmation statement Postal	110	None	110	
Online Confirmation statement	50	None	50	

EVENT	COMPANIES HOUSE FEE (£)	REGULATOR'S FEE (£)	TOTAL FEE (£)	NOTE
Annual accounts with CIC report	None	15	15	
Online voluntary dissolution	13	None	33	
Postal voluntary dissolution	18	None	44	

## NOTES

1. There is no CH conversion fee as such but as the conversion involves a change of name the £30 change of name fee is payable
2. Change of status (re-registration) is where a company changes from a public to a private company or vice versa in which case the re-registration fee of £124 (£139 in total) is payable but the change of name fee is not charged providing the change is only from Limited (Ltd) to Public Limited Company (PLC) or vice versa. If a more substantial change is made in the name the £20 online & £30 postal change of name fee would have to be paid.
3. This fee is payable where a CIC changes from a public to private company or vice versa. Full details of the fees charged by the Registrar are available from [Companies House website](#).

# Annual Community Interest Company Report

All the directors of a Community Interest Company (CIC) have an important additional obligation to prepare an annual community interest company report to be filed with their accounts. The purpose of the report is to show that the CIC is still satisfying the Community Interest Test, and that it is engaging appropriately with its stakeholders in carrying out activities that benefit the community.

The accounting period for a company and time in which the accounts and CIC Report must be filed are determined by the company's accounting reference date. It should be noted that the issue of a new certificate of incorporation on conversion of an existing company to a CIC does not change the accounting reference date. This means that where a company is converted a CIC Report will be required for the accounting period in which the

conversion took place even if the company was a CIC for only a short time during that period.

## Community Interest Company Report

The detailed form of the report will be a matter for the company but, as with the annual accounts, the Regulator considers that CICs should aspire to provide the fullest possible information rather than simply comply with the minimum requirements; as good practice it should, for example, outline how the CIC has ensured that the assets have been solely used for the benefit of the community the CIC serves.

Although the report is a separate document from the company accounts there is no reason why it should not be sent to shareholders and other stakeholders with the directors' report and annual accounts.

The report is delivered to the Registrar of Companies who will file it on the public record and pass a copy to the Regulator. Consideration of community interest company reports is an important element in the Regulator's monitoring role and in showing that the CIC continues to satisfy the community interest test.

## Minimum Requirements

The Regulations prescribe minimum requirements. These include:

- Information on the remuneration of the directors such as the total aggregate pay of directors, (This information does not have to be duplicated in the report if it is included in the accounts and the report states that the information may be found in the accounts)
- Details of what the CIC has done to benefit the community
- Details of how it has involved its stakeholders in its activities.
- Information on the transfer of assets to another asset locked body or otherwise at less than market value for the benefit of the community.

## Delivery and form of the community interest company report

The accounts and the community interest company report are separate documents, but are subject to the same delivery dates and must be delivered together to the Registrar of Companies with a fee (please see the Companies House website)

This short guide is not a statement of law.

The Office of the Regulator of Community Interest Companies does not offer legal advice on particular cases, or on the legal risks associated with particular proposed actions.



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Contacts us if you have any enquiries about this publication, including requests for alternative formats, at:

Office of the Regulator of Community Interest Companies

2nd floor, Companies House

Crown Way

Cardiff CF14 3UZ

Tel: 029 2150 7420 (24-hour voicemail).

Email: [cicregulator@companieshouse.gov.uk](mailto:cicregulator@companieshouse.gov.uk)

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