

Social enterprise or charitable status – a brief guide

Organisations operating for public benefit are often described as being one of two categories – either a charity or a social enterprise. However, these definitions are broad and within each there are many variations of form and structure, and confusingly these often overlap too!

This document aims to briefly summarise the two types of organisation and some of the differences between them.

What is a social enterprise?

In broad terms, a social enterprise is a business which has social/community benefit at its heart. They can be set up in a number of different ways – for example a simple company structure with a suitable objects clause, to a more formal recognition of the social purpose contained in a social benefit clause of a Community Interest Company (CIC).

In many ways social enterprise is an approach, not a structure; a philosophical commitment to providing community benefit rather than personal profit for the founders or shareholders. To be recognised by external bodies as a social enterprise they should:

- Have social and/or environmental objectives written in to their governing document
- Be an independent business
- Earn 50% or more of their income from trading
- Dedicate a reasonable proportion (50%+) of any profit made by the business to social/environmental purposes
- Have decisions made by at least three people
- Be limited by guarantee rather than shares

What is a charity?

A charity is also an organisation which is set up for the public good. All charities have a governing document, usually referred to as a constitution which contains clauses defining the nature of the organisation. These clauses will include 'objects' which explain why the organisation has been set up (its 'purposes'), a 'winding up' or 'dissolution' clause which explains where any residual assets will go if the organisation is wound up, plus details about how the organisation will elect trustees and conduct meetings.

A charity's trustees are the people responsible for ensuring the charity is being run solely to achieve its objects and for the benefit of its beneficiaries. The trustees are accountable to regulators, funders and other stakeholders and must ensure the charity's assets are protected and used only for their intended purposes. The charity's assets are 'entrusted' to the trustees but are not owned by them.

A registered charity will have charitable 'objects' which have been approved by the Charity Commission, and must operate solely to deliver these objects for the public

benefit. They will report annually to the Charity Commission. Only registered charities have a charity number

Whilst not regarded as businesses, charities and charitable organisations can still earn income and trade, but their ability to do so is restricted. Even if they are not trading, charitable organisations should still be run in as businesslike a manner as possible to ensure they meet all their regulatory requirements and safeguard their assets and beneficiaries. All the activities of a charity should be focussed on their pre-defined beneficiaries and the trustees are the unpaid overseers of this activity.

'At a glance' guide to the major differences

	<i>Social Enterprise</i>	<i>Charity</i>
Can it draw down grants?	Yes – although not all grant funders support social enterprises	Yes – and registered status helps to open up even more potential grant funds
Can it charge for services	Yes	Yes – but more restricted
Can it pay workers	Yes – including directors	Yes – but not trustees, except in exceptional circumstances
Does it have to register with anyone?	Yes – Companies House or CIC Regulator if incorporated; Financial Services Authority for mutual societies / co-operatives	Yes – Charity Commission if a CIO or income is over £5k. Some non CIO charities also choose to register with Companies House to gain benefits of incorporation
Does it provide 'limited liability' for trustees / directors	Yes if incorporated	Yes – but only if incorporated through CIO or Companies House registration
Can it campaign or get involved in 'political' activity	Yes	Yes – BUT, not party political and only associated with furthering charity's objects. Campaigning itself is NOT charitable – see CC9 from the Charity Commission
Are there limitations on fundraising or other activity it can get involved in?	No – free to be 'enterprising' in the way it generates income and delivers 'social benefit'	Yes – must comply with primary purpose as set out in constitution and agreed with Charity Commission. Charitable fundraising is also regulated by the Fundraising Regulator
Are there any tax benefits	No, broadly speaking, but there may be some scope	Yes – if registered with HMRC charities may be

	if bodies are non-profitmaking.	able to reclaim VAT and GiftAid. Registered charities may also obtain exemption from Corporation Tax – but check the small print re trading etc.
Can business rates exemptions be claimed?	No – although some local authorities MAY give some discretionary relief	Yes – registered charities are entitled to 80% rate relief, and many local authorities will also waive the other 20%
Does it have to comply with things like Health and Safety, Safeguarding etc.	Yes	Yes
Can it enter into contracts	Yes – but should only do so if incorporated	Yes – but should only do so if incorporated e.g. via CIO or Companies House registration. Otherwise contracts are with individual trustees rather than the organisation

Glossary

Asset lock – a clause in the governing document of a CIC which states that any residual assets leftover once the company has been wound up will go to a similar organisation rather than to the existing directors of the company. If no organisation is specified the CIC Regulator will decide. Other organisations may know this as a **dissolution** or **winding-up** clause

Charity Commission – oversees charities to ensure they comply with their governing documents and deliver public benefit. Registered charities send annual returns here

CIC – Community Interest Company – a form of company which embeds social benefit into its governing document, also includes an ‘asset lock’. Registered with Companies House and overseen by the CIC Regulator

CIO – Charitable Incorporated Organisation – relatively new legal form which gives charities the opportunity to become incorporated without having to set up a separate company

Companies House – all businesses need to register here and send in annual returns. There is a small charge for this

Constitution – the governing document of a charitable organisation is usually called a constitution

Corporation tax – a tax on the profits of businesses. Charities may be exempt depending on how their profits were derived - primary purpose trading is exempt, other trading may not be.

Director – member of the governing body overseeing the operation of a business. Could also work in a paid capacity by the organisation. In a CIO or charitable company directors can also be called trustees

Dissolution clause – also known as the ‘winding up’ clause, this explains what will happen to the residual assets of an organisation once all debts have been settled. Assets should go to a similar charitable organisation, which could be named specifically. Assets cannot be left to individuals.

Financial Services Authority – body overseeing mutual societies such as Industrial and Provident Societies (IPS)

Governance – process by which trustees (charities) or directors (businesses) ensure their organisations are run properly

Governing document – a document which sets out why and organisation exists and how it will operate. Charitable organisations generally work to a constitution, whereas businesses work to a memorandum and articles of association (mem and arts)

HMRC – Her Majesty’s Revenue and Customs – responsible for collecting taxes. Take independent advice as to whether or not your organisation would benefit from registering with them to obtain VAT concessions, GiftAID etc.

Memorandum and Articles of Association – also known as ‘mem and arts’, these form the governing document of a business

Objects – also known as ‘purposes’, define why a charity is set up. To be a registered charity the objects need to meet strict criteria set out by the Charity Commission

Trustee – member of the governing body overseeing the operation of a charity. On the whole, trustees cannot be paid by their organisation unless very specific measures have been agreed

Incorporation

Incorporation is the process of creating a corporate body which has its own legal identity, which can then enter into contracts and give limited liability to its members. Unincorporated bodies cannot offer limited liability to their members and contracts are made by individuals rather than the corporate body. The worries that trustees sometimes have around their personal liability can be mitigated by incorporating.

The benefits of incorporation:

- Separate legal identity to enter into contracts
- Limited liability – the organisation is liable for debts or other liabilities rather than individual trustees or directors PROVIDING the organisation has been run properly. Limited liability does not cover individuals if they act illegally, negligently or irresponsibly
- More freedom around earning income through trading
- Lighter touch regulation – unless also registered with the Charity Commission
- Charitable Incorporated Organisation (CIO) gives benefits of incorporation through the Charity Commission rather than Companies House, but as it is still a charity, restrictions on trading and paying trustees remain