Briefing Papers

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ADVANTAGES & DISADVANTAGES OF BEING A CHARITY

If you are considering setting up your entity as a charity, there are some issues that should be considered before making a final decision on the type of entity that is best for you. We look at the advantages and disadvantages of obtaining charitable status.

ADVANTAGES OF BEING A CHARITY

1. Tax exemptions: Charities are generally exempt from income/corporation tax (in the case of some types of income), capital gains tax, or stamp duty, and gifts to charities are usually free of inheritance tax.

2. Rates relief: A charity pays 20% of normal business rates on the buildings which they use and occupy – in many cases the local authority will award, upon application, the additional 20% as a further relief.

3. VAT: A charity can get special VAT treatment in some circumstances. *VAT reliefs are marginal and won't make a lot of difference unless major building work is involved.*

4. Fundraising: Charities are often able to raise funds from the public, grant-making trusts and local government and the public more easily than non-charitable bodies. Charities can reclaim gift aid on donations from private individuals. Businesses can claim CT relief on charitable donations.

5. Credibility: Charities are able to give the public the assurance that they are being monitored the Charity Commission.

DISADVANTAGES OF BEING A CHARITY

1. A charity must have exclusively charitable purposes: In general, the organisation would have to stop any non-charitable activities, (above certain thresholds) The non-charitable activities above the threshold can continue if carried on by a separate trading company, which can in turn gift aid any profits it makes to the charity.

2. Trustee Remuneration: Trustees are not allowed to receive financial benefits from the charity which they manage unless this is specifically authorised by the governing document. No more than 50% of the Trustees can be remunerated. Financial benefits include salaries, services, or business contracts to a trustee's own business. Similarly, where a spouse, relative or partner of a trustee receives such benefits, this is classed as Trustees' remuneration. Trustees are, however, entitled to be reimbursed for their reasonable out-of-pocket expenses.

3. Reporting requirements: Charity law imposes certain financial reporting obligations; these vary with the size of the charity.

4. Conflict of interest: Trustees need to avoid any situation where charitable and personal interests conflict.

5. Politics: There are limits to the extent of political or campaigning activities which a charity can take on
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ADVANTAGES & DISADVANTAGES OF A COMMUNITY INTEREST COMPANY (CIC)

A community interest company (CIC) is a special form of non-charitable limited company, which exists primarily to benefit a community or with a view to pursuing a social purpose, rather than to make a profit for shareholders.

ADVANTAGES OF A COMMUNITY INTERST COMPANY

1. A clear commitment to social goals: The statutory basis of the asset lock, which ensures that a CIC's funds will be used for the benefit of the company's social objectives rather than for individual shareholders, helps provide reassurance to investors and the wider public.

2. Access to certain forms of finance: Some donors will only give to charities or community interest companies, because of the protections these vehicles provide that funds will be used for stated purposes. Therefore, access to finance – whether through provide donors, grants or community development finance – may lead a social enterprise to operate as a CIC rather than as a standard company.

3. Limited liability and protection

4. Familiarity: The limited company structure, complete with directors and shareholders/members, is likely to be familiar to those responsible for running the organisation and relatively simple to operate

5. Flexibility of limited company structure: A CIC can be set up as a private company limited by shares, private company limited by guarantee or public limited company.

6. Quicker to set up: A community interest company is quicker to form than a charity, with a single consolidated application to form the company made to Companies House, which they and the CIC Regulator separately review. By contrast, a charity can take months.

7. Reduced governance requirements: There is also a lower level of ongoing governance for a community interest company than a charity. This relative freedom from regulatory restraints means that a CIC can focus intensively on its social aims, with fewer restrictions on trading activities than a charity faces meaning they can also take a more commercial approach to achieving their ends.

8. There are no remuneration restrictions: In contrast to a charity, the founders of a community interest company can retain control over the business while being appointed and paid fairly for their work as directors of the company. This can make it easier to attract additional high calibre individuals.

9. A wide range of possible social aims and specific focus on social enterprise: The social aims permissible and ways they can be pursued are wider for a CIC than a charity. The definition of community interest in the 'Community Interest Test' which applies to CICs is wider than the equivalent 'Public Benefit Test' which applies for charities. This means that many aims which would not qualify for charitable status can be pursued via a CIC.

The CIC model is specifically identified with social enterprise. For some this social element is something they want to emphasise. The ability to distinguish from a traditional charitable status may be seen as a virtue for some; more in keeping with their sense of purpose.

Over time, social enterprises are achieving a higher profile, as well as an independent, distinct voice within the third sector.

DISADVANTAGES OF A COMMUNITY INTEREST COMPANY (CIC)

The CIC model will not be suitable for everyone.

1. Formalities of incorporation: Like any standard limited company, a CIC must be registered at Companies House. Unlike other companies, a CIC must also submit form CIC36, with payment of a £35 fee, describing the proposed social purpose of the company and providing various other details. In order for the CIC to be established, this has to be reviewed and approved by the CIC Regulator.

2. Lack of tax breaks available: Charities are able to claim a number of tax reliefs on most income, capital gains and profits, they're typically eligible for a substantial discount on business rates. In contrast, CICs don't receive tax breaks, even if their objects are wholly charitable. This means that, all other things being equal, they'll potentially raise less money for their cause.

3. Limited access to certain funding: Certain grants and other funding schemes may be open only to charities and not to CICs. Where businesses have Corporate Social Responsibility (CSR) policies which govern who they can donate money to, these are still likely to favour charities over other vehicles.

4. Limited public awareness of the CIC model: Although the position is improving, many people – who the organisation might want to target as donors or volunteers, for example – will not be familiar with the CIC form. They may feel more comfortable offering their time, services or donations to a charity – a form they'll be more familiar with.

5. Perceived lack of prestige: Similarly, a CIC may not appear to carry the prestige of a registered charity; a registered charity generally carries a sense of trust that inspires confidence, which is not fully replicated by the CIC brand.

6. Restrictions on the use of assets: Alongside the dividend cap, there are also restrictions on how a CIC can use and dispose of its assets. In practice, this usually means that the company cannot transfer its assets or profits outside the CIC for less than their full market value. If the company is dissolved, surplus assets must be transferred to a socially focussed body, like a charity or another CIC.

7. Additional governance requirements: The CIC must report annually to the CIC Regulator which can only currently be completed and submitted on paper rather than electronically.

Daryl Martin – September 2018
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