



## Introduction to Legal Formats

### Overview

**Community Land Trusts (CLTs)** are a **legally defined concept** but they are not a legal format in themselves. Any prospective community land trust should choose a legal format which would enable them to meet the legal definition as legislated in the Housing & Regeneration Act 2008, Part 2, Chapter 1, Clause 79:

*A Community Land Trust is a corporate body which:*

*1) is established for the express purpose of furthering the social, economic and environmental interests of a local community by acquiring and managing land and other assets in order -*

- to provide benefit to the local community*
- to ensure that the assets are not sold or developed except in a manner which the trust's members think benefits the local community*

*2) is established under arrangements which are expressly designed to ensure that:*

- any profits from its activities will be used to benefit the local community (otherwise than by being paid directly to members)*
- individuals who live or work in the specified area have the opportunity to become members of the trust (whether or not others can also become members)*
- the members of a trust control it.*

This means that only certain **legal formats** would be suitable for a CLT to adopt. All legal formats must be designed to **benefit a designated community/the public/section of the public** - rather than members, or any private individuals such as shareholders. The legal formats need to protect the assets (such as land, buildings and money) of the CLT through a provision in the governing document (all legal formats have a governing document) called an **asset lock** - this will mean (amongst other things) that if the CLT is wound up any assets will have to go to a similar organisation once creditors have been paid (see Jargon Buster for more detail on Asset Locks).

The legal formats will dictate that any profit made by the CLT (and it should be planned for that the CLT will make profit) will only be able to be used to further the objectives of the CLT – so profits/surpluses will need to be **reinvested** in the CLT rather than shared amongst members as dividends. The legal formats must also contain provisions to offer opportunities for local people to become **members**, and for the members to control the CLT - thus ensuring that the trust is **accountable** to the local community.



The legal formats suitable for being a CLT can be:

- **Community Benefit Society** (also known as an Industrial and Provident Society for the Benefit of the Community)
- **Community Interest Company Ltd. by Guarantee** (also known as a CIC)
- **Company Ltd. by Guarantee which is also a registered Charity (or a Charitable Incorporated Organisation)**
- **Company Ltd. by Guarantee** (but only if it has custodian member of the constitution to ensure that the Asset Lock cannot be voted out).

The governing document would need to be designed to conform to the legal definition of a CLT. All these legal formats are **Limited Liability** – which means that the organisation has its own legal personality, so in the event of the CLT not being able to repay its debts, the liability of the members (including directors) is limited to either the amount they have paid for their shares (if a Community Benefit Society) or the amount they have guaranteed which is usually £1 (if a CIC Ltd. by Guarantee, Charitable Incorporated Organisation, or a Company Ltd. by Guarantee). The only eventuality leading to a member becoming individually liable for costs incurred by the CLT would be if that member acted ‘ultra vires’ (outside the law).

It is important to remember that a CLT is an organisation with a very **long life** since it is set up to ensure that assets are available and affordable for future generations. Although it is impossible to foresee every eventuality, when choosing a legal format a group should try to consider what the CLT may wish to do in the future as well as in the short term. This will help to avoid complications later on (such as needing to set up subsidiary or sister organisations which would involve additional cost and effort).

In considering which of these three legal formats to adopt prospective community land trusts need to consider which format would be most appropriate regarding several factors:

1. **Allowing the organisation to conduct its chosen trading activities**
2. **Being appropriate for the financial arrangements required (possibly attracting grants, taking loans and raising share capital)**
3. **Being effective, efficient and economical**
4. **Being democratic and enabling local and interested people to be involved**
5. **Its ethos (aims and values)**



## Community Benefit Society

The governing document of a Community Benefit Society is called its **Rules**.

Community Benefit Societies used to be called Industrial and Provident Societies for the Benefit of the Community and are similar to Co-operatives in how they operate. The key difference between the two is that Community Benefit Societies are set up to benefit the community whereas Co-operative Societies are set up to benefit their members (which is why a Co-operative Society could not be a CLT). The body which registers Community Benefit Societies is currently the **Financial Conduct Authority (FCA)**.

It is important to ensure that the Community Benefit Society established contains a statutory asset lock in its Rules, this is an option in many sets of Model Rules but is fundamental for CLTs in order to protect assets for the benefit of the community in perpetuity. There are two exceptions when a Community Benefit Society does not have to have an asset lock in order to be a CLT. One is if the Community Benefit Society is to be an exempt charity in which case being charitable is itself the asset lock. The other instance is if the CLT will be pursuing registration as a Registered Provider of Social Housing, as becoming an RP also comes with an asset lock. The impact of both charitable status and RP status is considered below.

### Charitable status

A Community Benefit Society can be charitable but does not have to be. There is a choice to be made.

#### **1. Allowing the organisation to conduct its chosen trading activities**

- On registering a Community Benefit Society objects need to be specified. These objects need to be carried on for the benefit of the community but they are not as restricted as the objects of a Registered Charity. As long as trading activities are conducted to help the Society to meet its objectives there are no restrictions on trade. In the case of a CLT this could potentially include land transactions, leasing land, renting properties, room hire, selling things such as renewable energy, fruit and vegetables, etc.

#### **2. Being appropriate for the financial arrangements required (possibly attracting grants, taking loans and raising share capital)**

- One of the main advantages of Community Benefit Societies is that they offer great flexibility in terms of financial arrangements. Community Benefit Societies can make and take loans, attract grant finance and issue share capital.
- A very special thing that Community Benefit Societies can do is raise share capital through a community share issue without the great expense



of a conventional public share issue. Shareholders become members with one vote each. A small amount of interest can be paid to shareholders (not comparable to a dividend, or profit share, more like the cost of acquiring finance, such as interest on a loan).

- There are no tax advantages to being a Community Benefit Society unless registering as an exempt charity with HMRC. If registering as an exempt charity the CLT will be a charity in law and subject to the same trading restrictions and requirement to prove that they benefit the public, however it will not need to report to the Charity Commission.

### **3. Being effective, efficient and economical**

- The Rules have to be checked by the FCA before a Society can be registered. The legal work this entails is expensive and so the most cost effective way to register a Community Benefit Society is to use 'Model Rules' supplied by a sponsor and pay a fee to this sponsor for use of their model rules and their work in registering the Community Benefit Society. The National CLT Network is a sponsoring body, please see the National CLT Network website for more information on this service. Other rules are also available with other sponsoring bodies, including Wessex Community Assets.
- A Secretary must be appointed and is responsible for ensuring the Society acts within the law. This requires some knowledge though is commonly carried out by informed volunteers.
- The Committee of Management can be paid although this will require approval by the members.
- Organising an AGM and notices to members will create some expense (room hire, printing, postage, etc.).
- The annual return to the FCA enables the Society to remain registered. There is a fine for not completing this. In order to maintain the register the FCA requires a payment which is dependent on the size of the Society. It starts at £55 and rises for £425 for assets of over £1m.

### **4. Being democratic and enabling local and interested people to be involved**

- The Rules will state who may become a member, this should be open to anyone working or living in the community, or wishing to work or live in the community.
- All members have one equal vote (regardless of the number of shares they hold).
- Members vote for and will be able to stand for the Committee of Management.
- There is a requirement to have an Annual General Meeting.



There is more information on the impact of charitable status in the National CLT Network resource 'Charitable status and its implications'.

Registered Provider of Social Housing status

CLTs may wish to become a Registered Provider in order to access capital grants from Homes England through the Community Housing Fund and the Shared Ownership and Affordable Homes programme.

CLTs cannot incorporate with an asset lock as it would clash with the asset lock inherent in achieving RP status however not having an asset lock in your constitution would mean your CLT does not conform with the legal definition of a CLT. It may be harder to access funding whilst your organisation does not have an asset lock as funding bodies may be uncertain of your community-led aims. CLTs should therefore be confident that they are going to become an RP fairly swiftly after incorporating before deciding not to have an asset lock. There is funding available from the Community Led Homes programme to become an RP but the process is lengthy which can be difficult for groups who have incorporated without an asset lock.

There are two options for CLTs who incorporate as CBSs with an asset lock that ultimately decide to become RPs. These are:

1. Dissolve the current CBS and set up a new organisation without an asset lock
2. Set up a new organisation without an asset lock as a subsidiary or arm of the original CBS and then transfer assets across

In 1. the group would have to explain to the regulator why they changed but this could be easily articulated as the reasoning is straightforward. In 2. the regulator is sometimes nervous about a newer organisation taking on the RP status, so a call to the regulator is advised to explain the group's history and reduce their nervousness. 1. is the simplest option but is more suited to early stage groups without substantial assets whilst 2. is more suited to more established groups who already have assets



## **Community Interest Company (Ltd. by Guarantee) - aka CIC**

The governing document of a CIC is called its Memorandum and Articles of Association. The regulator is the Community Interest Company Regulator. A CIC can be a company limited by guarantee, a company limited by shares or a PLC. CLTs must structure their CIC as a CLG .. The CLT network has a standard model for CLTs to adapt as necessary to suit their purposes.

A CIC Ltd by Shares is not a good legal format for a CLT as each share has one vote rather than each member having one vote. This jeopardises the community control since the voting power of each member is determined by the number of shares held. Also, CICs Ltd. by Shares may raise share capital, but a community share issue using a CIC would be expensive (CICs do not benefit from the special exemptions from the Financial Promotions Regulations which Community Benefit Societies do).

### **1. Allowing the organisation to conduct its chosen trading activities**

- CICs must have social objectives which must pass a community interest test. The social objectives are not as tightly defined as with Charities. The test is of the underlying purpose of the CIC – it is the end (or mission) which is important rather than the means (or activities). Activities cannot be detrimental to community benefit though.

### **2. Being appropriate for the financial arrangements required (possibly attracting grants, taking loans and raising share capital)**

- CICs are appropriate legal formats for attracting grants and loans.
- There are no tax advantages to being a CIC but local authorities may allow some local rate relief.
- CICs Ltd by Guarantee cannot raise share capital (and CICs Ltd by Shares cannot be CLTs as they are not fundamentally democratic being one share, one vote rather than one member, one vote).

### **3. Being effective, efficient and economical**

- CICs are inexpensive to set up, costing approximately £35 using model governing documents although legal advice will probably be required to tailor these rules to meet a CLTs requirement (the National CLT Network has a standard model suitable for CLTs to adopt).
- There is a requirement to produce an annual community interest report.
- There is an annual regulatory fee of £15 to be submitted with the community interest report.
- Committee of Management members may be paid in a CIC.



#### **4. Being democratic and enabling local and interested people to be involved**

- A CIC is similar to a Company in terms of membership. It can be set up (by including provisions in the Memorandum and Articles of Association) to allow anyone to become a member, have a vote at the AGM, and stand for the Committee of Management. Although, it is also permissible to have non-voting classes of members and to not have an AGM these provisions should not be included for a CLT. The memorandum and articles of association are open to future amendment by members (so democracy is not cast in stone in the same way as with a Community Benefit Society) but it can be if you have a Custodian Member.
- A Custodian Member is intended to be a permanent member with the right to veto the amendment of any Articles that require protection. Your local council could be invited to become your Custodian member.
- Sample Mem and Arts are available on the National CLT Network website.



## Company Limited by Guarantee Registered Charity

The governing document of a Company Ltd. by Guarantee which is a Registered Charity is the memorandum and articles of association (mem and arts). This legal format is regulated by two bodies, Companies House and the Charity Commission. Charitable Incorporated Organisations operate in the same way as Charitable Companies Ltd by Guarantee, apart from there is no requirement to report to, or register with, Companies House – only the Charity Commission.

### 1. Allowing the organisation to conduct its chosen trading activities

- This legal format is the most restricted one in terms of being able to conduct its trading activities. Charities cannot pursue trading activities outside of their primary purpose.
- Charities need to have charitable objects. Depending on planned activities, suitable ones for CLTs may be ‘prevention or relief of financial hardship’; ‘advancement of citizenship or community development’; ‘advancement of environmental protection or improvement’. When applying for registration it is incumbent on the CLT to prove it will be following and meeting those objectives in a public benefit test. This is strict as charities experience significant public trust and also substantial tax benefits.
- The charitable objects can be changed once registered. Any changes would have to satisfy the Charity Commission on the Public Benefit Requirement.
- It is possible to set up a wholly or partly owned trading subsidiary for a Charity which gifts profits back to the Charity. There is the obvious additional expense and regulation associated with this but it may be appropriate in some circumstances. See the definition of cross-subsidy in the Jargon Buster.

### 2. Being appropriate for the financial arrangements required (possibly attracting grants, taking loans and raising share capital)

- It is likely that CIOs will be unable to take on **secured borrowing** as the Charity Commission does not have the ability to establish or maintain a register of charges over CIO property. Lenders, therefore, are reluctant to grant CIOs secured debt.
- Charities are the ideal vehicle for attracting grants and donations. They can also attract loan finance. They cannot raise share capital.
- Some Charities can only transfer assets, such as land and buildings, to other Charities with similar objects. This is relevant if seeking to acquire assets from other Charities.
- Charities are restricted in their ability to generate profits (they must use their funds in furtherance of their objectives and must not have disproportionate levels of financial reserves). In deciding to set up a charity CLTs must appreciate the special nature and standing a charity has and that this is the



approach the Charity Commission will take when deciding whether or not to grant charitable status.

- There are tax benefits to being a Charity, including corporation tax relief and discretionary rate relief. Charities are exempt from tax on income received from renting out land or property that is held for charitable purposes, as long as the income is used for charitable purposes only. This includes profits from letting out furnished property. There is no exemption from tax for any profits made from developing land or property, for example if entering into a contract for a builder to develop and sell charity property. However when buying a property, a charity won't have to pay Stamp Duty Land Tax. This also applies when buying a lease where Stamp Duty Land Tax would normally be due. It is worth noting that currently transactions below £125,000 are not liable for Stamp Duty Land Tax, and for transactions between £125,000 and £250,000 the tax is 2%, rising to 5% for transactions between £250,000 and £925,000 (as of September 2017).

### **3. Being effective, efficient and economical**

- As Charities are the most heavily regulated legal format of the three, there is a larger amount of work required in terms of complying with charity law and regulation.
- However the advantages in terms of tax and levels of public trust may mean that this is an acceptable price to pay.
- Sample mem and arts are available on the National CLT Network website, however you may require additional legal advice. The more work a community group can do itself (ensuring that the business plan demonstrates how the CLT will meet each charitable object) the lower the cost.
- Companies Ltd. by Guarantee which are Registered Charities must submit annual returns to Companies House with a fee of £15.
- All registered charities must prepare a Trustees' Annual Report (TAR) and accounts and make copies available to the public. Charities in the income range up to £10,000 do not have to send them to the Charity Commission.
- Accounts will need to be filed, but a small company does not need to pay to have them audited.
- A board of Trustees must be unpaid, although reasonable expenses are allowed.
- Trustees have to understand the Public Benefit Requirement (see the Jargon Buster on the website).

### **4. Being democratic and enabling local and interested people to be involved**

- Beneficiaries of a Charity can also be members of it and sit on the Committee of Management as a Trustee. However there cannot be a majority of beneficiaries on the Committee and there must be a clear policy on Conflicts



of Interest to ensure accountability, propriety and transparency in decision-making.

- As with a CIC, the memorandum and articles of association can be set up to allow all members to vote but can also be set up to have non-voting classes of members.

This summary has been written as a guide. It is important to make a considered decision when choosing the legal format of your CLT as the cost of altering to a different legal form later can be great (if it is even possible). Further advice should be sought before a decision is taken, either by a Community Land Trust, or social enterprise adviser or a legal professional.



## Comparison

Legal Format	Company limited by guarantee/Charity	Community Interest Company	Community Benefit Society
<b>Open membership</b>	Yes	Yes	Yes
<b>Member Democracy</b>	Yes	Yes	Yes, one member one vote
<b>Trading flexibility</b>	Limited	Flexible	Flexible
<b>Beneficiary representation on Board</b>	Limited	Unrestricted	Unrestricted
<b>Payment to Board members</b>	Restricted	Unrestricted	Unrestricted
<b>Raise share capital at affordable cost</b>	No	No	Yes, using withdrawable shares
<b>Legally enforceable asset lock</b>	Yes	Yes	Yes
<b>Reporting and regulation</b>	Companies House and Charity Commission	Companies House and CIC Regulator	Financial Services Authority
<b>Tax advantages</b>	Rate relief Stamp duty exemption Corporation tax exemption	None	None, unless an exempt charity, in which case tax advantages are the same as CLG/Charity.
<b>Tax relief for donation</b>	Gift aid	None	None