

## Charities and social enterprise

### Introduction

Many charities deliver services as part of their activities and look to adopt the social enterprise business model to do this so achieve sustainability. This KaMSEN factsheet outlines some of the issues to consider.

### What is a charity?

The concept of charity has existed in UK law for over 400 years. It is a particular type of organisation which must have aims, purposes or objectives which the law recognises as charitable. It must also provide benefit to the public not to a specific individual. Charitable status sits alongside the charity's legal form which may be unincorporated or incorporated. Many charities are set up and run by philanthropists and usually undertake a range of activities all directed at fulfilling the charity's objective.

There are extensive legal provisions relating to the creation of charities and about how they operate, set out in the Charities Act 2006. The establishment and regulation of charities is overseen by the Charity Commission [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk). Charitable status attracts some tax benefits. For information about registering a charity, charitable status and tax see Charity Commission and HMRC websites [details below].

### Using social enterprise business model as a charity

Trading and social enterprise are important sources of funding for charities. In recent years many charities have developed trading activity in order to generate unrestricted income, often by developing products and services to meet gaps in the market and also benefit their client group.

Where a charity wishes to explore the idea of developing social enterprise activity, it is important to consider how this will work with regard to its charitable status, governance and current activity. This can involve a change in approach and sometimes a need for a governance review.

### Charities and trading

Charity law provides that a charity may engage with certain types of trading without affecting its tax position. Types of trading are primary purpose trading, ancillary trading and small trading.

**Primary purpose trading** – trading that is carried on by a charity on the course of carrying out a primary purpose of the charity. This includes trading which is carried out mainly by the people who benefit from the charity [beneficiaries].

**Ancillary trading** – where trade is carried out to support the main purpose of the charity eg running a bar at a theatre, so legally part of the charity's 'primary purpose trading'.

**Small trading** All charities can also carry out small amounts of other trade as long as the profits are used to further the aims of the charity, are within certain limits as to the amount of turnover and the activity does not involve significant risk. Section 46 Finance Act 2000 exempts from income and corporation tax charity trading profits, and some other income of charities, which would otherwise be liable to tax, provided that the trading turnover, together with the other relevant income, does not exceed a specified threshold.

**Trading subsidiaries** In some cases, and where different trading activities are envisaged, charities may decide to set up a separate trading arm of the charity which then covenants its profits back to the charity. income and corporation tax charity trading profits, and some other income of charities, which would otherwise be liable to tax, provided that the trading turnover, together with the other relevant income, does not exceed a specified threshold.

This non-charitable trading company is owned by a charity or charities to carry on a trade on behalf of the charity (or charities).

***Note** These trading types are closely defined. Charities and trading is a complex area involving charity and tax law and advice may need to be sought about how this applies in individual cases and the best approach. Information about tax and charities can be found on the Charity Commission website and on the HMRC website.*

## **Features and characteristics**

**Mission and objectives** Having a social objective is the key characteristic of a social enterprise, which needs to be aligned with achieving commercial objectives. A charity has social mission at its centre, usually expressed through its charitable objective.

**Trading** All social enterprises trade as a principle activity and seek to make a profit or surplus. Some have a mixed funding profile. Charities can trade if they wish subject to some limitations. Some charities do not choose to trade.

**Risk** In the same way as any business venture, a social enterprise takes risk to develop the business. Charities are subject to Charity Commission guidance for trustees on investment and can sometimes be risk averse.

**Decision making** The charity model separates trustee decision-making from beneficiaries, although many charities do seek to involve beneficiaries in the decision making process. Social enterprises are set up and run by socially conscious entrepreneurs.

**Type of activities** A social enterprise business activity may not be related to the social objective but the profits/surpluses are reinvested in the business or used to further its social objective. Within a charity all activities are directly related to achieving its charitable objective.

**Asset lock** A central characteristic of a social enterprise is that all the profits [surpluses] are reinvested in the business or used to further its social objective. This is known as an asset lock. As social enterprises may take a number of different legal forms, the strength of the asset lock may vary. By law all charities have an asset where any surplus must be retained by the organisation, and in the event of the charity ceasing to operate would be given to another organisation with similar aims. Charity Commission involvement would be required to approve this.

**Trading** In principle like any other business there are no limits on type of trading which a social enterprise can undertake, subject to general law. There are limits on type of trading which can be undertaken within the charity

#### **Practical points**

- Running a charity using the social enterprise business model may require a change of approach and time to develop
- Looking at how other charities have developed using the social enterprise model may be useful
- Build in skills capacity and governance review as part of the planning process
- Discussion is needed about approach to risk, and what will be required to plan the business
- If intending to set up a trading subsidiary check there is the power to do this
- All new businesses, including trading subsidiaries of charities, need start-up finance. If the charity is going to invest in a trading subsidiary in some way any investment must comply with rules relating to investment by charities

#### **For more information**

Charity Commission guidance and publications [www.charity-commission.gov.uk](http://www.charity-commission.gov.uk)

HMRC guidance and publications [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

NCVO [www.ncvo-vol.org.uk](http://www.ncvo-vol.org.uk)

Simply Legal – published by Cooperatives UK [www.uk.coop](http://www.uk.coop)

Simply Governance – published by Cooperatives UK [www.uk.coop](http://www.uk.coop)

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