

Conversion to a Charitable Incorporated Organisation (CIO)

Consultation on:

- **Process to allow a Charitable Company to convert to a Charitable Incorporated Organisation**
- **Process to allow a Community Interest Company to convert to a Charitable Incorporated Organisation**
- **Consequential provisions**

Contents

Part I - About this consultation

Topics of this consultation
Scope
Audience
Body responsible for consultation
Duration
How to respond or make an enquiry
After the consultation

Part II - Background

What are we consulting about?
Why are we consulting?

Part III - Proposals

Proposed measures
Questions

Part IV - Impact

Introduction
Our Assessment
Questions

Part I - About this consultation

Topic of this consultation

1. This consultation is about the introduction of secondary legislation under the Charities Act 2011 (the 2011 Act) which will allow two types of structure to convert to a charitable incorporated organisation (CIO) should they wish to do so.
2. The CIO is a relatively new form of incorporated legal structure that is designed to meet the particular needs of charity and is only available to charities. The corporate structure provided by the CIO meets a demand from the charitable sector for a structure which gives a charity a legal personality of its own, enabling it to conduct business in its own name, rather than in the names of its trustees. The capacity and powers of an incorporated charity are also clearer than those of an unincorporated charity and it can be easier for people dealing with an incorporated charity to assess the credit risk of doing so. The members and trustees/directors of an incorporated charity are usually personally safeguarded from the financial liabilities it incurs, which is not the case for unincorporated charities.
3. The other main option to achieve corporate structure is for charities to incorporate as a company limited by guarantee under company law (referred to in this paper as “charitable company”). However this means that the charity is subject to both company law and charity law requirements which results in charities having to submit to two regulatory systems. A CIO must only register with the Charity Commission (“the Commission”) and comply with the requirements of charity law.
4. Giving Community Interest Companies (CICs) and charitable companies the opportunity to convert to the CIO structure is beneficial because it will reduce the regulatory burden on those bodies that are currently required to account and report to both the Commission and Companies House. There is currently no conversion process for CICs to become CIOs and limited provision for charitable companies. The draft regulations will create such a conversion process for CICs and supplement the process in place for charitable companies.
5. Since the introduction of the CIO legal structure in 2013 it has proven to be a very popular choice of structure for new and existing unincorporated charities. Over 6,500 new CIOs have been established since its introduction and it now accounts for over 25% of new charity registrations. It is expected that the option

of conversion will be similarly popular for small charities that have opted for the company structure and for CICs.

6. Community Interest Companies (CICs) are not charities, so the conversion process proposed for CICs is slightly different to the conversion process for charitable companies, as it will entail the Charity Commission assessing whether the proposed CIO that will be formed by the CIC, would be a charity.
7. A complete list of questions asked in this consultation can be found in Parts III and IV.

Scope

8. This consultation applies to the law of England and Wales, as charity law is devolved in Scotland and Northern Ireland.
9. However we are consulting with the devolved administrations in Scotland and Northern Ireland regarding the proposed Index of Company Names (Listed Bodies) Order 2016 to seek their views on whether it should make provision in relation to Scottish and Northern Ireland CIOs.

Audience

10. Anyone may respond to this consultation and all responses will be fully considered. The Cabinet Office is particularly interested to hear from bodies that would be affected by these changes, particularly representatives of charitable companies or CICs who would like to take advantage of the opportunity to convert to a CIO following implementation of these regulations. We also welcome responses from charity sector representative bodies as well as members of the public who have an interest in charities.

Body responsible for the consultation

11. Cabinet Office Ministers are responsible for the legal and regulatory framework for charities in England and Wales and the Cabinet Office is responsible for this consultation.

Duration

12. The Government wishes to consult over 10 weeks from 1 April 2016 to 10 June 2016. The deadline for responses is 5.00pm, Friday 10 June 2016.

How to respond or make an enquiry

13. There are two ways to respond to the consultation:

Email:

Submit your response or enquiry via email to charities-act@cabinetoffice.gov.uk
Please title your response "CIO conversions".

Postal:

Send a written response to

Ben Harrison
Conversion to a CIO consultation
Office for Civil Society
Cabinet Office
4th Floor
1 Horse Guards Road
London, SW1A 2HQ

14. If you have any questions about the consultation, please e-mail them to charities-act@cabinetoffice.gov.uk
15. Respondents are asked to give a summary of their organisation, whether it is a registered charity and where relevant, whether they would like to convert to a CIO.
16. Representative groups are asked to give a summary of the people and organisations they represent, and where relevant, who else they have consulted in reaching their conclusions.
17. Responses to this consultation will be shared with the Commission and may be shared with other Government departments. Responses may be published in full or in a summary of responses.
18. All information in responses, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004). If you want your response to remain confidential, you should explain why confidentiality is necessary and your request will be acceded to only if it is appropriate in the circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

After the consultation

19. We will acknowledge receipt of all responses, and all responses will be considered. The aim is for a summary of the consultation responses to be published soon after the close of the consultation together with the Government's response. Subject to Parliamentary approval of the necessary Secondary Legislation, the aim would be for a phased implementation of the conversion process starting in October 2016 depending on the type of charitable company or CIC converting. However if implementation started later than 1 October 2016 then the phasing in dates would also change accordingly. Phased implementation is considered necessary to enable the Charity Commission to manage anticipated demand.

- **Proposed conversion timetable for charitable companies to CIOs:**
 - 1 October 2016: Charitable companies with an annual income greater than £500,000;
 - 1 December 2016: Charitable companies with an annual income between £250,000 and £500,000;
 - 1 February 2017: Charitable companies with an annual income between £100,000 and £250,000;
 - 1 April 2017: Charitable companies with an annual income between £25,000 and £100,000; and
 - 1 July 2017: Charitable companies with an annual income of less than £25,000

- **Proposed conversion timetable for CICs to CIOs: 1 October 2017**

Part II - Background

What are we consulting about?

Power to make the Regulations

20. The Charities Act 2006 (the 2006 Act) set out the broad legal framework for the CIO and was consolidated into the Charities Act 2011 (the 2011 Act). The 2011 Act provides the Minister for the Cabinet Office with a power to make regulations in relation to the conversion of charitable companies and CICs into CIOs.

21. Section 234 of the 2011 Act permits the regulations to make provision for the conversion of a CIC into a CIO and its registration as a charity. Section 246 of the 2011 Act allows the regulations to make further provisions for the conversion of a charitable company and CIC into a CIO, and section 231(3) of the 2011 Act permits the regulations to make provision about circumstances where it would not be appropriate to grant an application for conversion.
22. In accordance with section 348(4) of the 2011 Act, the Minister must consult such persons or bodies he as considers appropriate before making regulations. This is being carried out through consultation with various government departments and external stakeholders as well as this consultation with the public and other interested parties.

Aim of the legislation

23. The aim of the draft regulations is to allow CICs and charitable companies to convert to CIOs and to smooth the process making it as quick and simple as possible whilst ensuring continued accountability.
24. Currently there is no process for a CIC to convert to CIO and limited provision for charitable companies. As a result, they must set up a new CIO with the same charitable purpose as the original entity, transfer the assets of the original charity to the new CIO (once liabilities are settled or they have secured relevant permissions to transfer the liabilities to the new entity) and then wind up the original charity. This process is less attractive to charities because it potentially requires time, the renegotiation of contractual obligations, new bank accounts and charity numbers and associated additional costs. It is a particular problem for smaller charities because they are more likely to have fewer resources and less capacity to deal with the issues which would arise from the transfer and this is of concern because smaller charities are believed to be the part of the sector which is most likely to wish to transfer to the CIO structure.
25. On the other hand the enactment of this secondary legislation would allow CICs and charitable companies to smoothly transition to a CIO where they could take advantage of the benefits of a corporate structure whilst retaining their existing identity and avoiding the unnecessary administration and costs currently involved.

Why are we consulting?

Aim of the consultation:

26. The Government is committed to supporting charities and making them easier to run through reducing the regulatory burden and associated costs.

27. Providing charitable companies and CICs with the opportunity to convert to a CIO is essential to this commitment as it offers the option of a smooth transition to a structure that will allow charities to operate with their own legal identity where they can enter into contracts, reduce the risk for charity trustees and avoid the complexity of submitting to dual regulatory requirements.
28. The consultation seeks responses from all parts of the charitable sector and from the public. The responses will form an integral part of the development of the draft regulations and will be taken into account when determining the form of the final legislation.
29. The consultation will also aim to confirm whether there is a strong demand from charitable companies and CICs to have the option of conversion to a CIO. This must be confirmed to ensure that the regulations will be used once enacted.

Part III - Proposals for consultation

Introduction

30. Section 228 of the 2011 Act sets out the process for charitable companies to convert to CIOs. That is why the draft regulations only deal with information to be provided with an application to convert and circumstances where such an application may be refused.
31. However, the 2011 Act makes very little provision for the conversion of CICs to CIOs which is why the draft regulations set out the process in detail. These provisions have sought to mirror, where possible, the process for conversion of charitable companies, although the main difference is that CICs are not charities, so as part of the conversion process there will need to be an assessment by the Charity Commission of whether the proposed CIO meets the requirements of charitable status.

Charitable Company Conversion to CIO

32. Section 228 of the 2011 Act sets out how a charitable company can convert to a CIO.

33. Along with an application to convert, if the proposed constitution of the CIO includes provision for entrenchment, the charitable company must provide the Commission with a statement specifying that fact.
34. The draft regulations describe the circumstances where an application to convert by a charitable company should not be granted:
- a. there have not been filed with the appropriate registrar any accounts or reports required to be delivered under the Companies Act 1985 or the 2006 Act in respect of a financial year of the company which has ended by that date (this applies whether or not the period for filing the accounts or reports has expired);
 - b. there have not been transmitted to the Commission any reports or returns required to be transmitted under Part 8, Chapter 4 of the 2011 Act (annual reports and returns and public access to accounts etc) in respect of a financial year of the company which has ended by that date (this applies whether or not the period for transmitting the reports or returns has expired);
 - c. the company, or any of its directors, are in default of any requirement to send any documents or information to the appropriate registrar or the Commission.
35. Charitable companies will not be permitted to convert in these circumstances because if a charitable company falls into one of these categories it means that the Commission does not have all the information legally required of the charitable company and it would be inappropriate to make a decision on whether or not to grant a conversion without being fully informed of the financial and legal position of the charity.

Conversion of CIC to CIO

36. The 2011 Act makes very little provision for the conversion of a CIC. Therefore the draft regulations propose a process for the conversion from a CIC to CIO and this process seeks to mirror as closely as possible the process set out in the 2011 Act for charitable companies.
37. The draft regulations propose to allow CICs to apply to the Commission to convert to CIOs except in circumstances where:
- a. they have share capital and that share capital is not fully paid up; or
 - b. the charity resulting from the conversion would be an exempt charity.
38. Conversion of a CIC with share capital is prevented because CIOs do not have share capital and it would not be possible for a CIC to transfer its share capital when it converted to a CIO. A charity which would be an “exempt” charity following conversion cannot convert to a CIO because to become a CIO the

charity must register with the Commission, and an exempt charity cannot be registered with the Commission.

39. Along with an application to convert a CIC must supply to the Commission:
- a. a copy of a resolution of the CIC that it be converted into a CIO which may be a special resolution of the CIC or a unanimous written resolution signed by or on behalf of all the members of the CIC who would be entitled to vote on a special resolution;
 - b. a copy of the proposed constitution of the CIO;
 - c. if the proposed constitution of the CIO includes provision for entrenchment, a statement specifying that fact;
 - d. a copy of a resolution of the CIC adopting the proposed constitution of the CIO;
 - e. such other documents or information as the Commission may require for the purposes of the application. This information will be published by the Commission in its guidance for CICs on the conversion process prior to implementation and includes information required with an application for conversion.
40. If the CIC is a company limited by guarantee (whether or not it also has a share capital) then the proposed constitution in the application must provide for the CIO's members to be liable to contribute assets if it is wound up and provide the amount to which they are liable. This amount must not be less than the amount they would be liable to contribute if the CIC were wound up. If this amount is £10 or less then the guarantee no longer exists following conversion.
41. The Commission will then notify the Office of the Regulator of Community Interest Companies (the CIC Regulator), the registrar of companies and any other person who the Commission thinks appropriate. The Commission may consult the CIC Regulator and must consult the registrar of companies and any other person notified by it about whether the application should be granted.
42. When notified the CIC Regulator must decide whether the CIC is eligible to cease being a CIC and transfer to a CIO. In order for the CIC Regulator to say a CIC is eligible none of the criteria under s55(2) of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (the 2004 Act) must apply, which are:
- a. the CIC Regulator has under section 43 of the 2004 Act appointed an auditor to audit the company's annual accounts and the audit has not been completed,
 - b. civil proceedings instituted by the CIC Regulator in the name of the company under section 44 of the 2004 Act have not been determined or discontinued,

- c. a director of the company holds office by virtue of an order under section 45 of the 2004 Act,
 - d. a director of the company is suspended under section 46(3) of the 2004 Act,
 - e. there is a manager in respect of the property and affairs of the company appointed under section 47 of the 2004 Act,
 - f. the Official Property Holder holds property as trustee for the company,
 - g. an order under section 48(2) or (3) of the 2004 Act is in force in relation to the company,
 - h. a petition has been presented for the company to be wound up.
43. These circumstances would prevent a CIC from being eligible to convert to a CIO because in all of these circumstances the CIC Regulator is unable to confirm that the CIC is being run in a satisfactory manner or that it is in control of all of its assets and it would therefore not be appropriate to support a conversion.
44. Following its decision on whether or not a CIC is eligible to convert the CIC Regulator would then notify the Commission and an application can only be granted/declined once the CIC regulator's decision is received by the Commission.
45. There will be a right to appeal the decision of the CIC Regulator on whether a CIC is eligible to convert. The decision may be appealed to the appointed Appeal Officer for CICs.
46. An application to convert **must** be refused by the Commission where:
- a. it is not satisfied that the CIO would be a charity at the time it would be registered;
 - b. the CIO's proposed constitution does not comply with one or more of the requirements of section 206 of the 2011 Act (constitution of CIOs) and any regulations made under that section;
 - c. in the case of a CIC which is a company limited by guarantee, the CIO's proposed constitution does not comply with the requirements set out at paragraph 38 above; or
 - d. the CIC Regulator has determined in accordance with regulation 5 that the CIC is not eligible to cease being a CIC.
47. The Commission **may** decide to refuse an application to convert where:
- a. the proposed name of the CIO is the same as, or is in the opinion of the Commission too like, the name of any other charity;
 - b. the Commission is of the opinion referred to in any of paragraphs (b) to (e) of section 42(2) of the 2011 Act (power to require charity's name to be changed) in relation to the proposed name of the CIO (reading

paragraph (b) as referring to the proposed purposes of the CIO and to the activities which it is proposed it should carry on); or

- c. having considered any representations received from those whom it has consulted under regulation 4(2), the Commission considers (having regard to circumstances set out in regulation 4(3)) that it would not be appropriate to grant the application.

48. If the CIC Regulator decides a CIC is eligible to convert, and the Commission grants the application for conversion then the Commission will:

- a. register the CIO to which the application related in the register of charities;
- b. notify the CIC Regulator of the registration; and
- c. send to the registrar of companies a copy of the resolution of the converting CIC and the entry in the register relating to the CIO.

49. However it is important to note that the conversion of the CIC to a CIO only takes final effect when the registrar of companies cancels the registration of the CIC. To do so, the registrar of companies must register the conversion resolution and register entry of the CIC and cancel the registration of the CIC in the register of the companies.

50. Once the registration of the CIC is cancelled, the CIC is automatically converted into a CIO and if the CIC had any share capital at the time of the conversion the shares are cancelled meaning the holder of the shares loses any right to claim payment for them.

51. Once converted the CIO will still be subject to any liabilities that it was subject to as a CIC.

Accounting Requirements on Conversion

52. Under charity law there is a duty upon the trustees to maintain accounting records. The trustees of the new CIO will be under a duty to satisfy all accounting requirements set out in part 4 of the draft regulations.

53. The first requirement will be for the trustees to preserve at least six years of accounts of the charity, even if those accounts pre-exist the conversion to a CIO. For example if a charity converts to a CIO in March 2017 it still will be required to preserve its accounts from April 2011 - March 2017. This is important as the conversion to a CIO does not provide a clean slate for a charity and if there is a query about the financial position of the charity the preserved accounts will provide enough evidence to investigate or confirm the financial situation.

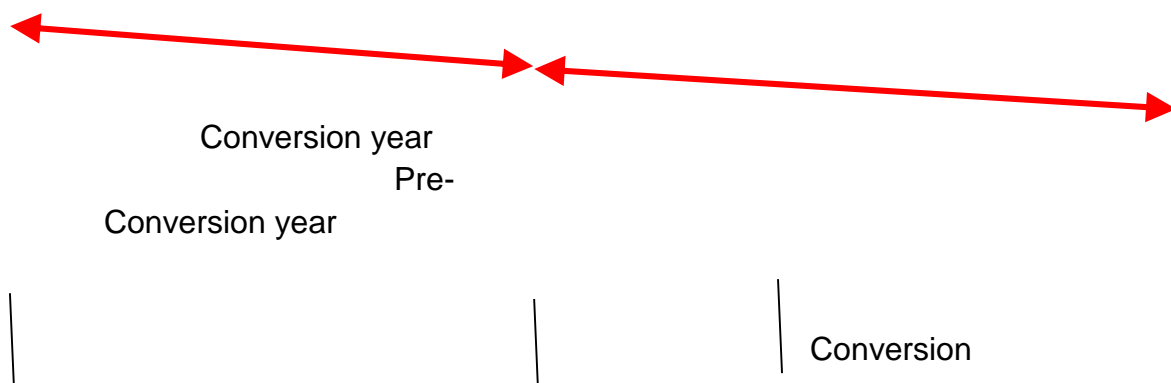
54. The charity trustees must also comply with the accounting requirements specified in the following sections of the 2011 Act:

- a. Section 132(1) - The trustees of the charity must prepare in respect of each financial year of the charity a statement of accounts;
- b. Section 138 - The trustees of the charity must prepare group accounts in respect of that year if the charity is a parent charity at the end of that year, and it is not required to prepare consolidated accounts for that year under section 399 of the 2006 Act;
- c. Section 144 - The accounts of the charity for that year must be audited if the charity's gross income in that year exceeds £1 million, or the charity's gross income in that year exceeds the accounts threshold (£250,000) and at the end of the year the aggregate value of its assets (before deduction of liabilities) exceeds £3.26 million;
- d. Section 162(1) - The trustees of the charity must prepare in respect of each financial year of the charity an annual report;
- e. Section 169 - Every registered charity must prepare in respect of each of its financial years an annual return.

55. The draft regulations provide details of how trustees should prepare a statement of accounts and/or group accounts depending on whether the financial year is before or during the conversion to a CIO.

56. For a financial year that begins and ends before the conversion to a CIO, this is called a pre-conversion financial year, and must comply with the requirements imposed on companies under the 2006 Act.

57. For a financial year beginning before and ending after conversion, this is called a conversion financial year, and must comply with the requirements imposed on CIOs under the 2011 Act. This means if a financial year is April 2017 - March 2018 and conversion happens in August 2017, the statement of accounts must be prepared according to CIO requirements even though for 5 months of the year the charity was not a CIO.



Consequential Orders

CIO Names

58. The registrar of companies is required to keep an index of the names of companies and other bodies. The Index of Company Names is used to prevent the registration of new companies with names that are the same as, or too similar to, existing entities on the index. The draft Index of Company Names (Listed Bodies) Order is a statutory instrument which would add CIOs to the list of bodies to which that index relates. It would prevent new companies from being registered if their proposed name is the same as or too similar to the name of a CIO.

59. We are consulting with the devolved administrations in Scotland and Northern Ireland about whether they would like the draft Index of Company Names (Listed Bodies) Order to make similar provision in relation to Scottish CIOs and/or Northern Ireland CIOs.

Right of Appeal against refusal of a conversion application

60. The draft Charitable Incorporated Organisations (Consequential Amendments) Order 2016 is a statutory instrument which will give CICs the power to appeal to the First-tier Tribunal a decision of the Commission to refuse an application for the conversion of a CIC into a CIO.

Phased introduction of conversions

61. In order to deal effectively with the expected demand for conversions alongside its other work the Commission will have to phase in the availability of conversions over a period of time and this will be done by the size and type of charitable company or CIC.

62. The proposed timetable below will allow the Commission to manage conversion applications along with its other workloads:

- a. 1 October 2016: Applications accepted for conversion of charitable companies with an annual income greater than £500,000
- b. 1 December 2016: Applications accepted for conversion of charitable companies with an annual income between £250,000 and £500,000

- c. 1 February 2017: Applications accepted for conversion of charitable companies with an annual income between £100,000 and £250,000
- d. 1 April 2017: Applications accepted for conversion of charitable companies with an annual income between £25,000 and £100,000
- e. 1 July 2017: Applications accepted for conversion of charitable companies with an annual income of less than £25,000
- f. 1 October 2017: Applications accepted for conversion of CICs

63. However if the implementation of the draft Regulations started later than 1 October 2016 then the phasing in dates would also change accordingly.

Questions

64. We would be grateful for your answers to the following questions:

Q1). Do you support the introduction of these draft regulations?

Q)2. Do you believe there is a demand for the introduction of these draft regulations? And if so, do you plan to take advantage of them?

Q)3. Are there any measures in the draft regulations that you believe should be removed or changed? For example, are there other circumstances in which it would not be appropriate for the Commission to approve an application for conversion beyond those that have been set out in the draft regulations?

Q)4. Are there any measures missing from the draft regulations that you believe should be included?

Q)5. Do you agree the measures should be phased in? Do you have any comments on the proposed phasing in of the measures?

Q)6. Do you have any other comments about the regulations or issues that should be considered?

Part IV - Impact

Our Assessment

65. The regulatory triage assessment carried out in advance of the publication of this consultation has provided our assessment of the impact the draft regulations will make. It can be viewed alongside this document.

Summary

66. The regulations are de-regulatory as they enable charitable organisations to reduce their regulatory burden and associated costs by providing for a simple conversion process for those organisations wishing to convert into a CIO from another corporate structure. The regulations are enabling and impose no direct cost burdens on charities or businesses. Only organisations that choose to convert will be affected and possibly incur indirect costs such as transitional administrative costs of converting.

67. Between 6,800 and 12,000 existing charities are expected to choose to convert to the CIO form as a result of this regulatory change over ten years. This would result in an estimated indirect one-off transitional cost of £4.1m - £7.2m (£603 per charity). However converting charities will then benefit from savings associated with reduced account preparation and scrutiny burdens. These indirect ongoing cost savings have been estimated at £3.5m - £6.2m (average) per annum (£932 per converted charity per annum).

Questions

68. We would be grateful for your answer to the following question:

Q)7. Do you agree with our assessment of the impact and effect this legislation will have?

Q)8. Do you have any comments to make on our assessment?