Early Years – BUSINESS RESOURCE TOOLKIT

TYPES OF LEGAL STRUCTURES AND ORGANISATIONS

Most privately run childcare providers will be either sole traders or limited companies and their governance arrangements are therefore fairly straightforward.

The legal form of most not-for-profit Early Years and Childcare Providers will either be unincorporated associations or a charitable company limited by guarantee. They will have a "constitution" which is a governing document (known as Articles of Association for a Company). The constitution will state whether or not the Board (or Management Committee) members are answerable to a wider group of people (known as a "membership") such as local parents and community representatives.

If an organisation is incorporated, it does not mean it is "private sector". There are a number of types of companies such as company limited by guarantee where the constitution can be amended to contain restrictions as to how surplus profits are used and assets are disposed of (for no personal gain), consistent with a not-for-profit organisation.

When setting up a childcare business one the first things you need to decide on is your legal structure. Also, from time to time and as the business develops, it should be considered whether a change in legal structure would be appropriate.

There is an introduction to legal forms on the website for the National Council for Voluntary Organisations http://www.ncvo-vol.org.uk/ (see below) with further information available on the website http://www.getlegal.org.uk.

The types of legal structures have been broken down in two areas:-

PRIVATE PROFIT MAKING
The main business structures are:

- Sole Trader
- Partnership
- Company

NON-PROFIT MAKING
There are a number of different legal structures for voluntary and community organisations in England:-

- Voluntary Management Committee (VMC) – Unincorporated Association
- Incorporated charity
- Community Interest Company (CIC)

SOLE TRADER
Sole trading is when an individual is the only owner of a business and has complete control of the way it is run.

Advantages:
- Simple to set up
- Straightforward accounting
- All the profit goes to you

Disadvantages:

- Personal liability for all business debts. This means that your home and other assets might be at risk if your business runs into trouble.
- Options for raising finance are more limited.
- Lack of support as no business partner to share responsibilities with.

PARTNERSHIP

A partnership is an arrangement between two or more people who share the risks, costs and responsibilities of being in business. It is good practice to have a partnership agreement drawn up. This will detail financial remuneration for each partner, the capital they have to invest and roles and responsibilities of each partner. A solicitor will be able to draw up such a document.

Advantages:

- Simple to set up with each partner registering as self-employed.
- New partner can be taken on to provide finance or expertise, different skills, knowledge and experience.
- Partners can provide mutual support.
- Shared decision making.

Disadvantages:

- Personal liability for any business debt including those incurred by other partners.
- Consulting with partners may result in disagreement and conflict.
- Decision making may take longer.
- Partners may have different aims and targets for the business.

COMPANY

A company is a separate legal entity which means that the company's finances are separate from the personal finances of their owners. A company can own property, incur debts, sue and be sued in its own right. Any business dealings are made on behalf of the company.

Most childcare companies are setup as a Private Limited Company which must have one or more members (e.g., director or shareholder). A limited company's rules are set out in its Articles of Association. This legal document must be carefully drafted; preferably with legal advice as the company has not power to do anything not covered by it.

Advantages:

- Personal financial risk is limited to the amount invested, either by shares or guarantee.
- A company can pay dividends to its shareholders and/or pay its directors a salary.
- A company has more credibility making it easier to raise finance and investment.
- Subject to corporation tax rather than income tax which can be advantageous to small business.

Disadvantages:

- More difficult and expensive to set up.
- More admin and paperwork including production and filing of financial information.
- Governed by more complex company legislation.

VOLUNTARY MANAGEMENT COMMITTEE (VMC) UNINCORPORATED ASSOCIATION

Being unincorporated is not a separate legal entity therefore, the committee members (trustees) who run such associations can be liable for the organisations debt.

Many voluntary sector businesses are registered charities; this enables them to apply for grant funding from charitable trusts and foundations. To be a charity an organisation must have charitable purposes that are for public benefit. The Charities aims and objects and how it must operate are detailed in its Constitution.

Advantages:
- Potential for additional support through grant funding or fund raising.
- Trustees will bring different skills, knowledge and experience to the committee.

Disadvantages:
- Admin as a result of registering as a charity i.e., accounts, charity law.
- East Trustee is personally responsible and liable for any debt.
- The risk of personal liability can deter people from volunteering to be trustees.

INCORPORATED CHARITY

Charitable companies are registered as a charity with the Charity Commission and are also registered with companies House. There are two types, companies limited by shares or by guarantee.

An Incorporated Charity Limited by guarantee does not have shares or shareholders and cannot distribute profits. Instead it has members who may pay a subscription and are each liable for a limited sum if it is wound up. This guarantee is commonly a nominal £1. The members elect a committee or board who have day to day control of the company. Where a charity is a company which is limited by shares the person who buys/owns the shares is only liable for the value of the shares if the company is wound up.

Advantages:
- Personal financial risk is limited to the among invested (the guarantee or shares).
- Costs involved with registering with Companies House are low.
- As the company is charitable, all the usual charity tax reliefs are available.
- As a charitable company there is potential for additional support through grant funding or fund raising.

Disadvantages:
- Strict legal requirements about annual general meetings, accounts and audit.
- Lots of paperwork and penalties for failure or delay to file information.
- Have to register and report to both Companies House and the Charity Commission and run by company and charity law.

COMMUNITY INTEREST COMPANY (CIC)

Community Interest Companies are limited companies with special additional features, created for businesses which are conducted for community benefit and not purely for private advantage. These types of business are often called social enterprises.

To ensure the company is established for community purposes, a CIC is subject to a community interest test and asset lock. Registration of a Community Interest Company has to be approved by the CIC Regulator, who also has a monitoring and enforcement role.

Advantages
- CIC's have much of the flexibility enjoyed by the private sector.
- Can have shareholders and pay directors.
- Not restricted to purposes which qualify as charitable.
- CIC's cannot be taken over and diverted away from the social enterprise of its founders.

Disadvantages:
- An organisation cannot be both a CIC and a Charity.
- Do not receive the tax advantages that would be available to charities.
- There are additional fees to pay to the CICs Regulator, as well as to Companies House.
- More regulated than charities.