Factsheet 3: A Guide to Community Companies

What is a community company?

The community company is a type of company designed to assist community groups in managing their assets and businesses.

The community company is intended to be run as a business, but instead of individual owners benefiting from the success of the business, the community as a whole will benefit.

The community company can in some cases be considered by existing groups as an alternative to charitable trusts and cooperatives.

If you learn nothing else, this is what you need to know about community companies.

- A community company must have a community interest, that is, where the community will benefit from the company's activities.
- Community companies cannot make any distributions of funds or pay any dividends to its shareholders. The community must receive the benefit.
- Community companies cannot make loans to directors or shareholders.
- There is a 'lock' on the disposal of assets of the community company.
- Directors must prepare a report on the activities of a community company each financial year.

What are the objectives of having community companies in Solomon Islands?

- To provide communities with a simple and cheap way to incorporate and operate.
- To provide clear obligations so the way the community company operates is well understood.
- To protect the communities through regular reporting of activities to the community.
- To give better certainty for third parties who want to do business with the community companies such as lenders, investors and other businesses.
- To protect and grow the community assets for current and future members.

How is a community company different from a charity?

Typically, groups who want to set up a community company would be entrepreneurial. The group may want to generate an income, but they want to do so for a community purpose, rather than just for themselves as individuals. A charity is likely to want to fulfil a community purpose, relying on external financial support.

What are the basic requirements for incorporating a community company?

- The requirements are the same as for incorporating any private company such as submitting the names and details of shareholders and directors, and company contact details in Form 1. A set of company rules must also be provided if they differ from the model rules in the Companies Act.
- The principal objective of the company must be that it promotes a community interest, so a statement of the company's community interest must be included in Form 1. The meaning of community interest is further detailed below.
- The name of the company must have the words "Community Company Limited" or "CCL" at the end in all communications. This is important because people who deal with Community Companies must **know** that they are dealing with a Community Company.
- The community company must have at least 1 shareholder and 1 director. The director must be a person and cannot be another company.
- The requirements for operating a private company apply, and details of this can be found in the Factsheet 1 The Companies Guide for Solomon Islands Business.
- No fee is required for the incorporation of a company.

If the documents are accepted by the Registrar of Companies, then they will be made publicly available in the Register, and the Community Company will receive a Certificate of Incorporation.

What is a community?

Since the purpose of the community company is to benefit the community, it is important to have a clear idea of **who** the company should be serving.

A community is a group of people who share a **readily identifiable characteristic**. If a reasonable person thinks that a particular group of people shares that readily identifiable characteristic, then this group would constitute a community.

Some groups may be readily identifiable, but a reasonable person might not think of them as a genuine community, for example "my friends" or "regular drinkers of XYZ beer". These types of groups are unlikely to be eligible to form a community company.

Often a community might be wider than the shareholders of the community company. For example, it might be "young unemployed people of Choiseul". Not every single young unemployed person in Choiseul will be a shareholder of the company, but they will all be part of that community.

Some examples of communities might include:

- Residents of KiraKira
- People with difficulties learning to read and write
- People who suffer from ABC disease
- Cocoa growers in North Malaita
- Women who make handicrafts in Honiara
- A Marau village wanting to expand its fishing operations
- A Rennel community wanting to grow more crops with a government grant.

A community company may **not** have as its principal objective, the promotion of a political purpose.

The definition of community is intended to be quite broad. The key is that the community must be wider than just the shareholders and employees of the community company.

What is a community interest?

In a normal company, it is the owners and employees who benefit the most from the business. A community company is different, because the main benefits must be for the community, rather than the individuals who own or run the company.

The Companies Act includes an important test, called the community interest test, which every community company must satisfy.

THE TEST

The community interest of the company must be where the benefit is to the community. This test is satisfied where a reasonable person might consider that the company is carrying on business to benefit the community.

In order to satisfy the test, it is worth looking at the:

- purpose of setting up the company;
- the activities which the company will participate in; and
- who will benefit from those activities.

Not every activity of the company needs to benefit the community directly, but overall, the activities should in some way, be beneficial to the community.

For example, if the company sells products that do not directly benefit the community, but the profits made from selling them are used for community benefits, then this will satisfy the community test.

It is also ok for the company to benefit its employees by for example, paying them a salary, or commissions of products they sell. This is because the company wouldn't be able to function properly at all if it didn't pay it's employees- and as a consequence, it would fail to benefit the community.

The key is that the company must have a wider benefit beyond just the shareholders and directors.

If an activity has a negative effect on the community, then this will not satisfy the test. Also, activities that are primarily political will not satisfy the test.

Who should be appointed as shareholders and directors?

The people who control the community company are the directors and shareholders. The decision about who will take these roles is made when applying for incorporation of the community company. They can of course be changed as well, as long the changes follow the company's rules.

The directors of a community company have the same duties as directors of any other company. They need to be able to understand what is happening in the general life of the company, how the company is performing financially, and how the company is benefitting the community. They have to act honestly, and they have to act in the best interests of the company- not in their own best interests. Directors of a community company have the same responsibilities as those of a private company. More information on these responsibilities, called directors duties, is contained in Factsheet 1 The Companies Guide for Solomon Islands Business.

The shareholders are the owners of the company. However, for a community company this means that they own their shares on behalf of and in trust for the community. They have to act and make decisions in a way which reflects the community's interest.

What are the special requirements of a community company?

In addition to the requirement that the community satisfy the community interest test, there are four basic rules of a community company that make them different from regular companies. The reason for these rules is to ensure that the community is protected and actually receives the benefits from the activities of the company. They are:

1. Community companies cannot make any distributions of funds or pay any dividends to its shareholders.

2. Community companies cannot make loans to directors or shareholders.

3. There is a 'lock' on the disposal of assets of the community company.

4. Directors must prepare a report on the activities of a community company each financial year.

The next parts look at these requirements in some more details.

1. No distributions or dividends to shareholders

A dividend is a way for a normal company to pass on the profits of the company to its shareholders. For a community company, since the shareholders are people who represent the community, it would not be fair to make a distribution to those individual people. Instead, of distributing the profits this way, the profits are kept within the company, and are used to benefit the community as a whole.

2. No loans to directors or shareholders

Making a loan to a director or a shareholder is another way individuals have been able to take a company's capital outside of the company. Often the loan is paid back to the company, but sometimes it is not. This is another situation where someone might personally benefit from the money a company makes, rather than having the community as a whole benefit.

3. The 'lock' on disposing assets of the company

Before deciding to register a community company ***it is very important*** to understand the asset-lock, because it has long term consequences.

Sometimes companies will want to dispose of an asset that it no longer wants or needs. For example, if a tuna company no longer needs a fishing boat, because it has decided that it will only process tuna, rather than fish for it, then it might sell the boat.

Can a community company still borrow, using its assets as security?

Yes, the company can still benefit from the possibility of receiving loans from banks or third parties, as long as the company can satisfy the lender's requirements. If the company cannot pay its debts, however, the company would have to sell those assets to meet the debts. It will be up to the lenders to decide if they want the shareholders to pass a resolution which allows the company to dispose of assets if the lender needs to recover its loan.

If a community company wanted to make this decision, then it should be one that the community agrees on first. The community should also be comfortable that the best possible price was found for the boat. So the Companies Act requires that 75% of the shareholders agree to the sale, and that it is sold for its market price.

All members of the community would also need to be notified before any decision is made to sell an asset.

These protections ensure that the community is happy with the decision, and that the full value of the sale stays within the company.

The 'lock' only applies to assets which are outside of the ordinary course of business. So if there are assets, such as canned tuna, which are produced everyday, then it would not make sense to require the community to be informed, and for shareholders to vote every time a can of tuna was sold.

Community companies may also include stricter rules on the disposal of assets in its rules if the community wishes. For example, it may want to specify particular assets which can't be sold, or it may want to ensure 100% of the shareholders agree to the sale.

4. Directors must prepare a report on the activities of a community company each financial year

Every financial year, the directors of the company must provide a report to the community and to the registrar (there is a specific form available with Company Haus for this report) outlining for that year:

- Remuneration (such as salaries or other benefits) received by directors
- How the company's activities benefitted the community
- What consultations were undertaken with the community
- What, if any, assets were disposed of by the company.

If the directors do not provide this report, then every director will be liable for an offence under the Companies Act and can be fined.

The report will be made available to the public through the company registry.

Are there any limits to how much a director can be paid in a community company?

It is up to each community company to decide how much it will pay its directors. The rules of the community company will determine how directors are paid, and would typically require that the shareholders approve of the director's remuneration.

The directors must also report to the registrar each year how much they are being remunerated, and this information will be publicly available.

Does a community company have to involve the community?

Community companies are encouraged to involve their community as much as possible in the activities of the company, and the directors are required to report to the registrar every year on their involvement with the community.

This information will be made publicly available.

How does the community company compare to using a charitable trust or a co-operative?

There are approximately 200 charitable trusts registered in Solomon Islands, which are regulated by specific legislation and by the courts.

The trust must have a charitable purpose – such as promotion of a sporting activity, or promoting education. The purposes are limited by the list in the Act, or specific declarations made by the Prime Minister. A community company can, on the other hand, have any purpose- provided that it satisfies the community interest test.

A key difference between a charitable trust and a community company, is that the trust is first concerned with its charitable purpose, whereas, the community company might first be concerned with operating a viable business.

Co-operatives are a type of association where the object is the promotion of the economic interests of its members in accordance with 'co-operative principles'. Incorporations of co-operatives are quite complex, and should be undertaken with appropriate professional advice. It is currently more straightforward for a group to form a charitable trust or a community company.

A community company may not always be the most appropriate structure for a group to use, however, the additional protections and reporting requirements do provide a transparent framework for groups wishing to undertake business activities while preserving the community's assets.

Are there any tax benefits in having a community company?

There are no specific tax breaks in having a community company versus another type of company. They are not a type of charity. Their intention is to create a business that will generate profits. The profits will be subject to company tax, like any other type of company.

How can a community company raise money so it can operate?

A typical trading company's source of finance is **trading income**. This is the money that comes into the company from selling its goods or services. Because a community company has restrictions on how cash can be spent, the hope is that community companies will be able to build up cash reserves to build the business and provide more community benefits.

A second form of sourcing funds is through applying for **grants** from government and donors. The grants may often cover the start up costs of a business, or money to provide for further expansions of the business. The community company structure may be attractive to donors, because the donor will know that the structure is transparent and has built in protections for the community.

A third source of income is through **borrowing**. Typically, a lender will require some security in return for lending the money, such as security over any land or real estate of the company, or, over other types of property such as machinery, or stock. The lender may also have other requirements which the community company must satisfy in order to receive a loan. The new secured transactions registry and law reforms are intended to assist with providing security over loans. Go to www.stfosi.com for more information about these options for the company's moveable property.

What are the rules of a community company and what are the model rules?

The Companies Act contains a copy of the model rules of the community company. These are a set of rules which govern how a company must operate. They include rules about shares and shareholders, directors, company records and accounting. They also include the rule regarding the asset lock.

Any community company can use these model rules, or that can modify them, or they can product their own version of the rules. Any rules, however, are subject to the Companies Act. This means for example, even if a community company chooses not to include a rule about an asset lock, it would still need to comply with the asset lock rules under the act.

What if a regular private company wants to convert to a Community Company?

The company must complete Form 1, and submit it to the registry, with a receipt for the fee paid at the treasury counter and a copy of the rules if they are different from the model rules in the Companies Act.

The rules (formerly known as the articles of association) would also need to be amended to ensure that they are in line with the requirements of the community company. These include, for example, a statement that the company is a community company, provisions regarding the asset lock as well as other key features of the community company. The model rules in the Companies Act may be used by the company (see below).

Remember, that the consequences of converting into a community company are long term. Assets that could otherwise have been sold would be subject to the asset lock provisions applying especially to the community company. The additional restrictions and reporting obligations will also now apply to the company.

How can a company cease being a community company?

A community company cannot be converted into a regular private company or a public company to avoid its community obligations, as this will inherently go against the community interest of the company.

A community company can only cease being a community company by dissolution in the same way any private company can cease to be a company, subject to one key difference.

If a community company is liquidated, then if there are any assets leftover after paying creditors and others who have made valid claims, then the assets will be distributed to shareholders in accordance with the proportion of the shares they own. The shareholder must then hold those assets on trust for the benefit of the community.

A member of the community may also apply to the court for the court to make an order for particular assets to be held by a member of the community.

Further information and questions?

Further information can be obtained by contacting the registrar of companies at esaramo@yahoo.com.au, telephoning 26812, or attending the registry during office hours in front of the immigration and commerce building, next to the Heritage Park Hotel. Brochures will also be made available at the Gizo and Auki offices of the Department of Commerce.

IMPORTANT NOTICE

The contents of this Community Company fact sheet are for guidance only. They are not legal advice.

The Registrar provides only general guidance and does not provide legal advice on individual cases.

Individuals should seek separate advice from a legal professional.