

Property Development – the benefit of a Trading Subsidiary Company

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Status of Paper	Final
Action required	Decision
Resolutions	89/1. The Council receives the report. 89/2. The Council directs the Property Development Committee to draft Memorandum and Articles of Association for establishing a wholly owned trading subsidiary company for undertaking property development on behalf of the Property Development Committee and the Council.

1. A discussion was held with the Strategy and Resources Committee in the last connexional year [April 2017, SRC/17/12] regarding the potential need for a wholly owned trading subsidiary company of the Methodist Council for property projects.
2. Being a charity obviously means the Church benefits from tax exemptions on the following sources of income/gains:
 - Donations (whether from individuals or corporates);
 - Investment income such as interest and dividends;
 - Rental income;
 - Trading profits (in limited circumstances);
 - Capital gains, subject to certain anti-avoidance provisions for land and buildings.

Trading as a Charity

3. Trading profit exemptions only apply where the trading activity of the charity is either primary purpose or ancillary purpose trading. Most trading activities that a charity undertakes will be primary purpose trading that directly contributes to the objects of the charity eg selling tickets for a local church concert. There will be other activities that are ancillary trading that indirectly contribute to the work of the charity eg selling food in a church café. The other type of trading that a charity might do is non-primary purpose trading, which will be intended to raise funds, but the activity itself will contribute to furthering the objectives of the charity. There is no black and white list of activities that are primary purpose and non-primary purpose trading. However, where a charity is undertaking non-primary purpose trading, consideration needs to be given to the establishment of a trading subsidiary company.
4. The Methodist Council, in undertaking property developments/investments of connexional property with a view to raising funds, but not necessarily contributing to the mission of the Church, will be non-primary purpose trading eg the redevelopment of a church building for leasing to a hotel business. There will be some occasions such as at Camden Methodist Church where it could be argued that this is ancillary trading. However, for the purposes of this paper, the property development work is being considered non-primary purpose trading.

5. The benefits of establishing a wholly owned trading subsidiary to be responsible for and enter into the legal contracts for property developments would be:
 - To protect the charity's assets from the risk of trading, even where the risks are not significant;
 - To separate the administration of trading and charity activities for accounting and management purposes;
 - To ensure that transactions are at an arms length and therefore the charity's resources are being utilised effectively eg the company pays for use of office space and staff where appropriate;
 - To reduce the tax liabilities arising from non-primary purpose trading.

Tax Implications and Risk

6. A charity is permitted to undertake non-primary purpose trading that has a turnover of £50,000 without being subject to corporation tax. However the likelihood, and hope, is that the turnover from the property developments will be well over £50,000 and therefore liable to corporation tax. Setting up a company would mean the distributable profit could be passed to the Methodist Council via Gift Aid, therefore meaning no corporation tax has to be paid.
7. There is significant risk associated with undertaking property developments even with professional advice and prudent decision making processes. Whilst the assets of the Church as a charity would be sufficient to meet the costs of carrying out the property projects being proposed (at least at the initial stages), it is unlikely to be well received by the wider connexion if Methodist Church funds have to be utilised to fund a property project that has not gone to plan.
8. Professional advice has been obtained from lawyers and tax advisers who all suggest that best practice would be establishing a wholly owned trading subsidiary, to be the party to legal documentation and holding the property assets (thereby ring-fencing them).

Directors of the Company

9. The Company would be a wholly owned trading subsidiary company of the Methodist Council with the Council appointing and having the power to remove the directors. In the immediate future the company would only exist in name with no staff or significant resources. The directors of the company would be the same as the members of the Property Development Committee ensuring that the Property Development Committee continues to direct the development of the property in accordance with the adopted property strategy.

Company without staff or significant resources

10. Where a subsidiary company is established by a charity, there will be a number of considerations from a tax perspective, including:
 - Funding the subsidiary company initially and on-going – whether this is by way of loan and/or equity the charity will need to be satisfied that this constitutes an approved charitable investment/loan for tax purposes;

- Intra-group transactions – consideration of the transfer pricing provisions in relation to intra-group transactions and the sharing of resource between the parties;
 - Administration – the subsidiary company will have annual obligations in relation to the filing of accounts and a corporation tax return/computation.
11. For the time being it is not anticipated that the company will have any employees and any Connexional Team time spent on property development work will need to be paid for by the company. There will be a need for some seed funding from the funds under the control of the Methodist Council in order to establish the company and ensure it is compliant with the necessary financial and company regulations. Exact details on what funds will be required are still to be assessed but will be kept to a minimum with there being no intention to employ staff or purchase resources. The funding required and the viability of this proposal will depend significantly on the response of the Charity Commission to the proposal of transferring Model Trust properties to the trading subsidiary for nil payment. The legal advice has been that the proposal should be agreed by the Charity Commission on the basis that the company is a wholly owned trading subsidiary of the Council. Clarification is also required on the Stamp Duty Land tax exemptions that will apply.
 12. Transferring the properties to the company would enable the company to secure its own funding and to act as guarantor where necessary to loans that the Council has to enter into (as was done with the loan to MIC Ltd). It will also ensure that the company can enter into the legal contracts without the Council or Property Development Committee needing to do so as unincorporated bodies with potential personal liability to the members.

VAT Considerations

13. Whether the trading subsidiary needs to be registered for VAT is another area on which further advice is required but the initial advice received is that VAT registration would mean that the company is able to recover some VAT on costs in relation to any supplies subject to VAT (standard, reduced or zero rate) that it will be making.
14. In light of the professional advice obtained to date, and having considered the reasons for and benefits of establishing a wholly owned trading subsidiary company for undertaking property development on behalf of the Property Development Committee and the Council, it is proposed that the company be established. The first step will be to set up a new company with Memorandum and Articles of Association which will be similar to those approved by the Methodist Council for the Methodist International Centre Limited. Whilst work is undertaken to establish the company in name, further consideration and advice will be obtained on the ability to transfer Model Trust property to the company and how the projects can best be funded if the trading company is the body ultimately responsible for the developments and therefore bears the risk and financing.

*****RESOLUTIONS**

89/1. The Council receives the report.

89/2. The Council directs the Property Development Committee to draft Memorandum and Articles of Association for establishing a wholly owned trading subsidiary company for undertaking property development on behalf of the Property Development Committee and the Council.