



What does “not trading for profit” mean?

Basic info

When a local authority decides whether a Housing Benefit claimant's landlord is not trading for profit it looks for evidence of two things:

- That any surplus of income over expenses is not channelled to the landlord's own members, directors, trustees etc
- That the landlord's members, directors, trustees etc do not derive personal benefit from the landlord's accumulation of capital assets (such as property and cash at the bank)

There are several ways in which landlords are traditionally incorporated or constituted in order to ensure they comply with the above requirements. Even if a landlord is constituted in a way that suggests non-profit trading on the face of it, local authorities will also want to be sure that the members, directors or trustees etc do not gain advantages that are inconsistent with the organisation's apparent not-for-profit status (a practice sometimes referred to as “disguised profit” - see “What is disguised profit?”).

More info

Not-for-profit incorporation or constitution models vary depending whether the landlord is a company, a society, a partnership or an unincorporated association.

Company

There are two ways in which the members of a company (i.e. those who own and control a company) can limit their personal liability for the company's debts:

- In the case of a company limited by shares, the members' liability is limited to the amount that they agree to pay for their shares. Having paid this amount they cannot be personally liable for any further sum. The amount might be a token sum of, say, £1
- In the case of a company limited by guarantee, the members' liability is limited to an amount that they pledge to pay in the event that the company is dissolved owing debts. Again, the guaranteed amount might be a token sum.

The shareholders of a company limited by shares are normally able to sell their shares for whatever amount a willing buyer is prepared to pay: this could be considerably more than the amount originally paid. Shareholders also are normally entitled to take a dividend from the company - a payment of income from the company's profits. Therefore a company limited by shares will not normally count as a not-for-profit company for Housing Benefit purposes. But in the case of a company limited by guarantee, there are no shares to buy and sell and the members do not normally receive a dividend. Therefore a company limited by guarantee is the usual model for a company that does not trade for profit.

There is a further mechanism by which a company can ensure its not-for-profit



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status and that is by having an “asset lock” written into its Articles of Association. See “What is an asset lock?”.

Community Interest Company

The corporate status of Community Interest Company (CIC) was introduced by the Companies (Audit, Investigations and Community Enterprise) Act 2004. A CIC is a kind of “halfway house” between a charity and a conventional trading company: it is less rigorously regulated than a charity and in particular has some commercial freedoms. At least 65% of a CIC’s profits must be used for a specified community interest, but the remaining 35% can be paid as a conventional dividend to shareholders. This allows a CIC to raise capital by issuing shares: something a charity cannot do. However, a CIC’s assets must be “locked” so that they can never be transferred to anyone other than a charity or another company with a similar asset lock.

Because a CIC is able to distribute 35% of its profit as a dividend to shareholders it is debatable whether a CIC must automatically be regarded as a not-for-profit body. But if the CIC has adopted Articles of Association that commit all of its profits to community benefit and prevent the payment of dividends to shareholders at all it is more likely to be accepted by the local authority as a not-for-profit body for Housing Benefit purposes.

A CIC is often wholly owned by a charity, which means that any profit ultimately benefits the charity rather than the individuals who run the company. See Commercial company owned by a registered charity below.

Society

A Registered Society (formerly known as an Industrial and Provident Society) may well count as a not-for-profit body for Housing Benefit purposes - especially if it is a “community benefit society”. For more information about Registered Societies see, “Tell me more about registered societies”.

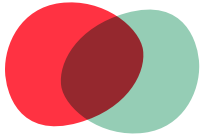
Limited Liability Partnership

A limited liability partnership (LLP) is the corporate status favoured by professionals who provide advice with major financial implications for their clients: solicitors, accountants etc. The partners are taxed as natural persons on their share of the LLP’s income but the LLP has its own legal personality and the partners’ liability is limited to whatever amount they agreed among themselves to be liable for in the event of the LLP being wound up.

It is not conventional for people setting up a not-for-profit concern to choose the LLP incorporation model and there is normally no reason to think that an LLP is not trading for profit.

Unincorporated association

An unincorporated association means an organisation that does not have its own legal personality: the organisation’s assets are owned by the people who run the organisation and those people are personally liable for the organisation’s debts. In



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order to be regarded as a not-for-profit organisation for Housing Benefit purposes, an unincorporated association needs to be able to demonstrate to the local authority that it is not trading for the commercial benefit of the people who run it. One way of doing this is for the organisation to be governed by some kind of written constitution, trust deed or similar document. The 1982 case of *Conservative and Unionist Central Office v Burrell*¹ contains the following summary of what it means to be an unincorporated association:

- "Where two or more persons are bound together for one or more common purposes by mutual undertakings, each having mutual duties and obligations, in an organization which has rules identifying in whom control of the organization and its funds are vested, and which can be joined or left at will."

Many registered charities operate as unincorporated bodies run by trustees.

What if the not-for-profit body makes a surplus?

Making a surplus does not necessarily cast doubt on an organisation's not-for-profit status. What matters is how the surplus is used, for example:

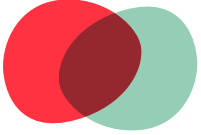
- Many long-established housing associations own a lot of their housing stock outright, with no lease charges or mortgage payments to cover. They still charge rent which often provides more income than the housing association needs to manage and maintain its stock. But the surplus enables the association to buy land and pay for the construction costs of new property to ensure that it is able to meet its objective of providing affordable accommodation to people who need it
- It is good practice for a registered charity to build up reserves so that it can continue to function in the event of a sudden interruption in funding

Commercial company owned by a registered charity

From the charity's point of view there are three main advantages in owning a subsidiary company (often referred to as a "charitable trading company"):

- Legal constraints: the activities of registered charities are regulated by the Charities Act 2006 and if the charity wants to undertake any activity outside the scope of what is permitted for a charity it will need to set up a subsidiary company to do so. For example, a charity is not permitted to make a profit from activity that is not linked to its primary purpose, but there is nothing to stop a charity from receiving donations from a company that makes a profit from such activity.
- Risk: the charity's liability is limited to the amount it paid for its shares in the company, or the amount it guaranteed in the case of a subsidiary company limited by guarantee
- Tax: the trading company is able to donate its profit to the charity by way of "gift aid", which means the company pays no corporation tax and the charity receives a tax-free donation

Sometimes the charitable trading company rents out accommodation and makes a profit that way. For Housing Benefit purposes this raises the question whether the claimant's immediate landlord is a not-for-profit organisation: on the one hand, all the shares in the trading company are owned by the charity and so any profits the company makes are for the benefit of the charity; on the other hand, the trading company has its own legal personality, quite distinct from the charity that owns its



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shares, and if its objective is to make a profit that does seem to create a difficulty in satisfying the landlord requirements for exempt accommodation. A local authority will probably be more inclined to regard a subsidiary trading company owned by a charity as a not-for-profit landlord if it has some kind of guarantee written into its Articles of Association ensuring that it will always trade only for the benefit of the charity: for example, there might be a clause preventing new shares from being issued to persons other than the charity; or the subsidiary company might be incorporated as a Community Interest Company.

The question whether a profit-making subsidiary trading company can still be regarded as a not-for-profit body if it donates its profits to the parent charity was referred to (but not decisively answered) by the Upper Tribunal in *Wirral Borough Council v MF (HB)* [2013] UKUT 291 (AAC) at paragraph 81:

- “Further, it has occurred to me that in other situations it may (I stress may) be relevant to look outside the constitution of the Provider/landlord in determining whether the accommodation it provides is exempt accommodation. Such a situation might be when, for tax or other reasons, the Provider as a wholly owned subsidiary of a registered charity covenants its profits to that charity.”

1. [1982] 1 WLR 522