



From incorporated association to a company limited by guarantee: Part 1 — comparison of legal structures suitable for NFPs

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- Appropriate structure for NFP influenced by size and areas of operations, both currently and in the future
- Incorporated associations administered by states or territories while ASIC regulates companies limited by guarantee

When incorporating a not-for-profit (NFP) organisation, there are several entity types to choose from. The first part of this article will focus on and compare the two most common entity types used by NFPs, being incorporated associations and companies limited by guarantee. The second part sets out the requirements and procedure for an association to convert to a company limited by guarantee.

Considering and comparing the differences between these two entity types will give some insight into which entity type is most suited to the needs of the NFP, both with respect to the establishment of a new NFP and assessing whether a current NFP's entity type is suitable now and in the short to medium term. If, on review of an NFP's current circumstances, it determines that an incorporated association is no longer the most appropriate entity type and it ought to be a company limited by guarantee, in most states and territories there are

conversion mechanisms available that will maintain the NFP's legal identity throughout the process.

Care should be taken as, in certain circumstances, there are laws that require organisations which are undertaking specific activities to adopt a particular legal structure. For example, there are Victorian laws that require organisations that provide housing services to the public and want to become a 'registered housing association' to be a company limited by guarantee. As such, a choice of entity type may not be available to an NFP in certain circumstances.

Basic information

While the table on the following pages provides a detailed breakdown of many of the differences between an incorporated association and a company limited by guarantee, it is helpful for an NFP deciding which structure to use to first answer the questions set out below.

- What geographic area does the NFP cover or intend to cover? That is, does the NFP operate across multiple states and/or territories or intend to do so?
- What is the size, scope and nature of the NFPs proposed or actual activities?
- What is the amount and type of property, money and other assets held or to be held by the NFP?
- What capacity does the NFP have to properly meet its corporate governance, administration and legal and regulatory compliance obligations internally and/or externally?

Even when considering an incorporated association as against a company limited by guarantee, there are different ways of using these entities to build an organisational structure. For example, the following organisational structures may be put in place to best suit the objects and needs of the NFP:

- a single incorporated association
- a single company limited by guarantee
- an incorporated association as an Australian Registered Body
- multiple incorporated associations
- a single company limited by guarantee with multiple state-based branches and
- a single company limited by guarantee with one or more subsidiary organisations.

Future plans

A small NFP that depends on volunteers, operates in one state only and has no intentions to expand outside of its home state in the short to medium term would almost certainly opt for an incorporated association. In fact, the stated purposes of most incorporated associations' legislation is to provide a vehicle for small non-commercial community organisations of this nature.

This is not to say, however, that an incorporated association cannot have employees or cannot be, or grow to, a significant size. In NSW, for example, the amount of \$2 million as a measure of assets, income or expenditure is used as a threshold guide, meaning that an NFP that exceeds this amount should, at least in NSW, start to think about whether an incorporated association is the most appropriate entity type.

On the other hand, an organisation that does, or intends to, operate nationwide, has many employees, undertakes a broad range of activities and has in excess of \$2 million worth of assets, income or expenditure is likely to find that a company limited by guarantee is the most appropriate option.

Of course, the answer is not always clear cut. For instance, an NFP may be reasonably small, only have one or two employees but 'operate' across one or more state borders. In these circumstances it probably doesn't make sense to establish, or convert to, a company limited by guarantee just so the NFP can operate in multiple states. In this

case, the NFP should consider applying for an Australian Registered Body Number (ARBN). Being an Australian Registered Body enables an NFP to remain as an incorporated association while freeing it to operate in multiple states. Becoming an Australian Registered Body does, however, mean that the NFP, and the members of its management committee, will be required to comply with certain parts of the *Corporations Act 2001*, most notably the provisions dealing with directors' duties and the requirement to display its ARBN after its name on all public documents.

Operating in more than one state

The law is unclear about what exactly constitutes 'operating' in another state. The answer is to be determined on a case-by-case basis with proper consideration of all the facts at the time. However, holding one-off or occasional activities (for example, and annual fundraising dinner) in another state is unlikely to constitute 'operating'; however, opening a premises or carrying on more regular or substantial activities might.

As yet another model, some NFPs choose to establish a separate association in each state or territory it wishes to operate and strives to keep a common and consistent approach through inter-entity agreements or memoranda of understanding. While this approach can be the most appropriate option in some circumstances, care should be taken before taking this path as it can lead to conflict and confusion and may do nothing more than double the amount of administration and legal compliance.

An alternative to the multi-association approach is to establish a company limited by guarantee at the federal level and then establish branches for each state through the use of delegated authority, terms of reference documents and/or company policies and procedures.

In some more sophisticated models, a company limited by guarantee may incorporate each of its branches as an independent, but related, corporate entity. It should be noted, however, that the more complicated the structure, the more resource-intensive it will be to operate and the more difficult and costly it will become to ensure that good corporate governance and legal compliance practices are developed and maintained.

Reporting obligations and requirements

Finally, it is worth noting that in the recent past many NFPs have made a decision on entity type based on the record-keeping, reporting and auditing requirements and have therefore, on balance, opted for an incorporated association. While this factor should be part of any consideration, it should not be determinative. This is true now more than ever since the introduction of a tiered reporting and accounting regime for companies limited by guarantee (see Table 1) and the fact that many associations may very well need to be audited under associations law, under charitable fundraising law or because a government or philanthropic grant giver requires it.

Table 1 sets out important information, including the legal requirements and obligations of an incorporated association and a company limited by guarantee not already discussed above.

Note: the information provided in Table 1 relating to incorporated associations does not provide a state-by-state breakdown and instead draws upon common themes and approaches. NFPs wishing to incorporate as an association should visit the webpages of its local Fair Trading or Consumer Affairs office to learn more about the requirements in its home state.

Table 1: Comparison of incorporated associations and companies limited by guarantee

Topic	Incorporated association	Company limited by guarantee
What is it?	<p>An incorporated association:</p> <ul style="list-style-type: none"> is a body corporate incorporated under specific associations incorporation legislation in the state or territory in which it operates and must use the word 'Incorporated' or the abbreviation 'Inc' after its name 	<p>A company limited by guarantee:</p> <ul style="list-style-type: none"> is a type of public company incorporated under the <i>Corporations Act 2001</i> and must include the word 'Limited' or the abbreviation 'Ltd' after its name unless it has been acknowledged by the Australian Securities & Investments Commission (ASIC) as a 'special purpose company' <p>Note: Most companies limited by guarantee that are established for a charitable purpose and do not pay their directors in their capacity as directors will qualify as special purpose companies</p>
Areas of operation and trading activities	Can only operate in the state or territory in which it is incorporated	Can operate and carry out its activities anywhere in Australia
Governing law	Each state and territory has its own incorporated associations legislation and associated regulations. These laws contain broadly similar obligations and requirements	<i>Corporations Act 2001</i> and <i>Corporations Regulations 2001</i>
Regulatory body	The relevant state regulator, usually a Department of Fair Trading or Office of Consumer Affairs	ASIC
Cost	<p>Fees range from \$61.20 to \$166 for application for incorporation depending on the jurisdiction.</p> <p>Certain jurisdictions also charge fees for the lodgment of annual financial reports</p>	<p>A company limited by guarantee tends to be more costly to establish and have higher ongoing compliance costs than an incorporated association. ASIC imposes the following fees:</p> <ul style="list-style-type: none"> \$351 application for registration fee (plus an additional \$351 if the company is a special purpose company and wishes to have the word 'Limited' removed from its name) \$1,069 annual review fee unless the company is a 'special purpose company', in which case the annual review fee is \$42

Topic	Incorporated association	Company limited by guarantee
Separate legal entity	<p>Has a separate legal identity, distinguishable from its members, and:</p> <ul style="list-style-type: none"> • is capable of performing all the powers of a body corporate • is capable of suing and being sued in its own name and • has perpetual succession and power to acquire land and dispose of property 	<p>Has a separate legal identity, distinguishable from its members, and:</p> <ul style="list-style-type: none"> • is capable of performing all the powers of a body corporate • is capable of suing and being sued in its own name and • has perpetual succession and power to acquire land and dispose of property
Application for incorporation	<p>An application must be lodged with the government department responsible for administering the relevant law pertaining to associations by a person authorised by the association to do so.</p> <p>While there are differences depending on the jurisdiction, generally, the application must be made by a person who is 18 years or older and who is resident in the state or territory.</p> <p>Again, while there is some variation depending on jurisdiction, the application will require providing information about the association's:</p> <ul style="list-style-type: none"> • objects and rules • proposed name • address and • details of the management committee and the public officer. <p>State regulators typically take up to two months to approve an application for incorporation</p>	<p>An application must be lodged with ASIC and include details such as:</p> <ul style="list-style-type: none"> • the proposed name • details of members and directors and secretary • address of the registered office and principal place of business and • details of any holding company. <p>ASIC typically approves an application for incorporation of a company within 48 hours of the application being lodged</p>
Rules or constitution	<p>Many jurisdictions have a set of model rules which will apply unless they are amended. Any rules of an association including amended model rules must comply with the law in the relevant jurisdiction and may, depending on jurisdiction, be required to include certain mandatory provisions relating to:</p> <ul style="list-style-type: none"> • membership qualifications • name, constitution, membership and powers of the management committee • calling and procedures for general meetings • alteration of objects • statement of purposes and rules and • dispute resolution. 	<p>A company is not required to have a constitution and may instead rely on the replaceable rules in the <i>Corporations Act 2001</i>, or a combination of both. A copy of the constitution must be lodged with ASIC.</p> <p>Note: It is strongly recommended that a company limited by guarantee adopt its own constitution and does not rely upon the replaceable rules. This is because the replaceable rules have not been drafted with a NFP entity in mind and often do not make sense in a NFP context</p>
Membership	<p>The number of members required for an incorporated association ranges from one to seven, depending on the state or territory of registration. For example, in NSW, an incorporated association must establish a committee with a minimum of three members. In Victoria, an incorporated association is required to have a minimum of five members.</p> <p>There are no age or race restrictions on membership.</p> <p>Members do not have a proprietary interest in the association</p>	<p>Must have at least one member. Consequently, this structure may be beneficial for proposed wholly owned subsidiaries.</p> <p>There is no maximum membership number.</p> <p>There are no age or race restrictions on membership.</p> <p>Members do not have a proprietary interest in the company</p>

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Directors and other officers	<p>While there is some variation depending on jurisdiction, the management committee of the association must have at least two members. However, if the model rules are followed, provision is usually made for four office bearer positions and three general positions.</p> <p>There are some slight differences depending on jurisdiction, but generally an officer of an association must:</p> <ul style="list-style-type: none"> • not make improper use of position • take all reasonable steps to ensure the association complies with the relevant associations incorporations law • disclose any direct or indirect pecuniary interest in a contract and • not allow the association to trade while it is or would be insolvent 	<p>A company limited by guarantee must have at least three directors at least two of which must ordinarily reside in Australia. Under the Corporations Act, directors must:</p> <ul style="list-style-type: none"> • act in good faith, in the best interest of the company and for a proper purpose • not make improper use of information or position • act with care and diligence • disclose any material personal interest in matters relating to the affairs of the company and • not allow the company to trade while it is or would become insolvent
Secretary / public officer / contact person	<p>There is no requirement for an incorporated association to have a secretary. However the majority of jurisdictions require there to be a public officer who is 18 years or older and who resides within the relevant jurisdiction. A public officer, in the incorporated associations context, is much like a company secretary. While sharing the same name, the position of public officer in the incorporated associations context is different from being appointed as the 'public officer' as may be required by the Australian Taxation Office (ATO), though the one person may fill both roles</p>	<p>Must have at least one secretary, at least one of which must ordinarily reside in Australia. A secretary must be 18 years or older.</p> <p>Generally, a company limited by guarantee will be required to appoint a public officer and notify the ATO of the appointment. A public officer is the liaison between the company and the ATO. Penalties can apply if the notice of appointment is not lodged within three months after the company starts carrying on business or deriving income in Australia</p>
Meeting of members	<p>The rights of members to vote and call meetings is generally decided by the group and written into the rules of association.</p> <p>Must hold an AGM at least once a year within five or six months (depending on jurisdiction) after the end of its financial year.</p> <p>The first AGM must be held within 18 months of the incorporation of the association.</p> <p>Must generally prepare an annual statement of accounts prior to an AGM</p>	<p>A small percentage of members are, commonly five per cent, able to call a members meeting.</p> <p>The company must hold an AGM at least once a year within five months after the end of its financial year unless it has only one member.</p> <p>The first AGM must be held within 18 months of incorporation</p>
Records	<p>While there is some variation depending on jurisdiction, an association must keep:</p> <ul style="list-style-type: none"> • accounts and records regarding its transactions and financial affairs, so true and fair accounts can be prepared and audited • minutes of all general and committee meetings and • a register of members 	<p>A company must keep:</p> <ul style="list-style-type: none"> • a register of members, options and charges and • financial records regarding its transactions and financial position and performance, that would enable true and fair financial statements to be prepared and audited

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Reporting	<p>While there is some variation depending on jurisdiction, associations must prepare an annual statement of accounts, prior to an AGM, that includes:</p> <ul style="list-style-type: none"> • income and expenditure • assets and liabilities and • mortgages and charges. <p>Whether the annual statement accounts of an association is required to be audited generally depends on the revenue generated by the association in the relevant financial year. The relevant revenue thresholds vary between jurisdictions, and in some cases an association must be generating more than \$200,000 of revenue before it is required to have its accounts audited.</p> <p>Within six months after the end of its financial year, an association must lodge an annual return with the relevant regulatory body.</p> <p>Within one month after the date of each AGM, a statement containing certain financial information of the association must be submitted to the relevant regulatory body</p>	<p>The Corporations Act distinguishes a 'small company limited by guarantee' as when, among other requirements, the revenue of the company is lower than the annual revenue threshold amount of \$250,000 and the company is not a deductible gift recipient at any time during the financial year.</p> <p>A small company limited by guarantee has no obligation to report unless requested by its members or the ATO.</p> <p>Where a company's annual revenue is less than \$1,000,000, the financial report must be prepared and lodged with ASIC but is not required to be audited, unless the company is a Commonwealth company or authority.</p> <p>A company limited by guarantee with annual revenues over \$1,000,000 must:</p> <ul style="list-style-type: none"> • prepare financial reports and directors' reports which comply with prescribed accounting standards • have the financial reports audited and obtain auditor's reports (the auditor of a public company must be independent of the company) • send the financial reports, directors' reports and auditor's reports to its members • lay the financial reports, directors' reports and auditor's reports before an AGM and • lodge the reports with ASIC.
Winding up	<p>Can be wound up under the relevant law governing associations in its jurisdiction voluntarily in certain circumstances or by a court. On winding up, any surplus assets are generally distributed in accordance with the constitution. It is common for NFPs to provide that any surplus is to be distributed to a body corporate with similar purposes to it.</p> <p>A court can wind up for a range of reasons, including:</p> <ul style="list-style-type: none"> • inability to meet debts • trading or securing a pecuniary gain for members • engaging in activities inconsistent with its objects • the committee acting in its own interests rather than for the objects of the association or • on just and equitable grounds. <p>On the winding up of the association, any surplus assets must be distributed to an association with like purposes and must not be distributed to the members.</p> <p>Note: in the event that the association is an Australian Registered Body under the Corporations Act, the winding up provisions under the Corporations Act will apply to it.</p>	<p>Can be wound up voluntarily in certain circumstances or by a court. On winding up, any surplus assets are generally distributed in accordance with the constitution. It is common for NFPs to provide that any surplus is to be distributed to a body corporate with similar purposes to it</p>

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Limited liability	<p>Liability is limited, usually to membership and subscription fees paid in accordance with the association's rules.</p> <p>Members will not be liable to contribute any money for unsatisfied liabilities in the event of dissolution or winding up, except to the extent that their membership or subscription fees are outstanding</p>	<p>The liability of members is limited to that amount which they have agreed to contribute on the dissolution or winding up of the company, in the event that the company's assets are not sufficient to discharge all of its debts or all its liabilities.</p> <p>The maximum amount of the contribution is fixed upon incorporation and stated in the company's constitution. It is typically a nominal amount in the order of \$10</p>
Amalgamation	<p>Legislation relating to incorporated associations generally allows for them to amalgamate, with all of the assets, liabilities and staff automatically transferred to the amalgamated association without the need for winding up or termination of employment</p>	<p>The Corporations Act does not have an equivalent provision</p>
Availability of information to the public	<p>Generally, only the details of the public officer needs to be provided to the regulator, which is then available to the public for a fee. An association must keep a register of members' details. However access to this register is a matter for the members of the organisation to agree on in the rules</p>	<p>For a company limited by guarantee, certain details of the directors must be provided to ASIC and these details are then available to the public at a fee. A company is also required to keep a register containing the details of members of the organisation, and is required to make this available to all members for free and to the public for a fee</p>

The second part of this article, to follow in the August 2012 issue of this journal, will cover the process of converting from an incorporated association to a company limited by guarantee.

 You can hear a podcast on this topic at www.CSAust.com/knowledge-resources/podcasts

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