

Fact sheet: What does 'not-for-profit' mean?

Overview

This fact sheet explains the term 'not-for-profit' and the difference between a not-for-profit (or nonprofit) organisation and a for-profit (businesses) organisation.

Once your group is clear about its aims, membership and activities, your group will need to decide whether it is going to operate as a 'not-for-profit' organisation. This is important because there are different legal structures for 'for-profit' and 'not-for-profit' organisations and different laws apply to each. This website only provides legal information about the activities of not-for-profit organisations.

Note: The information contained in this fact sheet is intended as a guide only, and is not legal advice. If you or your organisation has a legal problem you should talk to a lawyer before making a decision about what to do. The information in this fact sheet is written for people or organisations resident in, or affected by, the laws that apply in Victoria, Australia and is current at 1 October 2008.

What is a 'profit'?

Most organisations need money to carry out their activities. An organisation may raise money by charging its members fees, holding raffles, seeking donations from the public, applying for grants of money from the government, or in many other ways. An organisation will have a 'profit' (a surplus) if it has extra money left over, after it has paid all its bills and expenses (for example, paying room hire, coffee and tea expenses, telephone bills, insurance premiums and employee wages).

So, is a 'not-for-profit' organisation one that makes no profit?

No. Whether your organisation is a 'not-for-profit' organisation is determined by what your organisation does with that profit, not by whether your organisation makes a profit.

In a 'not-for-profit' organisation, the profits are not distributed to the individual members of the organisation while the organisation is in operation or when it ends. Instead, any profit that the organisation makes must be used to further the purposes of the organisation. That is, the profits are re-invested (put back) into the organisation, to continue to pay for its activities and functions.

A 'not-for-profit' organisation can make a profit?

Yes! Not-for-profit organisations can make a profit. In fact, it might be a good idea for a not-for-profit organisation to aim to have a small profit each year, to be able to pay for unexpected expenses or to

start new programs. Not-for-profit organisations can also:

- ▶ employ people and pay them reasonable salaries;
- ▶ make money by charging members of the public for services;
- ▶ make money by selling or leasing property; and
- ▶ invest money in shares and receive dividends.

It is what the organisation does with the profit, (rather than the fact it might have made a profit), which makes the organisation non-profit. For example, in a not-for-profit organisation, any of the profits that the organisation makes (from the sale of services or property) must be used to carry out the organisation's purpose and must not be distributed to members or any other individuals.

So, how is it different in 'for profit' (business) organisations?

In a 'for-profit' organisation (such as a business), the profit may be distributed to the organisation's owners, or to individuals members or shareholders. In a 'for profit' organisation, people who are involved in the organisation are entitled to receive a personal benefit from the profits of the organisation (such as a dividend, or money when they sell their shares, or a payment directly from the profit). It can be a little confusing as some of these 'for-profit' organisations operate in the community sector (for example, in childcare and aged care).

Why is it important to determine whether we are a not-for-profit?

It is important because there are different laws that apply to 'for-profit' and 'not-for-profit' organisations. Many of these laws treat not-for-profits favourably – on the basis that the organisation hasn't been set up by people to make a personal profit, and that the resources of the organisation will be put back in to helping the community For example:

- ▶ legal structure: if your organisation wants to incorporate, there are particular legal structures that are only available to not-for-profit organisations (such as an incorporated association);
- ▶ tax laws: the tax laws offer a number of tax exemptions, concessions or benefits to eligible not-for-profit organisations (although being not-for-profit is only one of a number of requirements);
- ▶ funding: some government grant programs and many private philanthropic bodies are set up only to fund not-for-profit organisations; and
- ▶ fundraising: some laws only allow not-for-profit organisations like charities and community groups to apply for registration to conduct certain fundraising activities (like minor gaming activities).

There is information about incorporation, legal structure, tax laws, funding and fundraising in other sections of the PilchConnect website.

We want to start a for-profit organisation - what do we do?

If any members of your organisation want to make money or some other kind of personal gain from the activities of the organisation (other than as reasonable payment for wages if they are employed by the organisation) then your organisation won't be a not-for-profit organisation.

The PilchConnect website only provides legal information for people who are in or are setting up not-for-profit organisations. There are different laws that apply to for-profit organisations.

We want to start a not-for-profit organisation - what do we do?

It's a good idea to make it clear to all people involved that the group operates on a not-for-profit basis. That way everyone knows they are not entitled to personally receive any profits from the organisation, and that all its money and assets must only be used to further the purposes of the organisation.

It is also important to make the not-for-profit status of your organisation clear to the public. This is because many of the legal benefits available to not-for-profits (such as low cost incorporation, tax concessions and the ability to conduct fundraising activities) may only be accessed by your organisation when it can prove its not-for-profit status.

Many organisations have a constitution, or a statement of purposes and rules. This is the document that contains the rules of the organisation, and describes its basic aims, structure and processes. To indicate that your organisation operates on a not-for-profit basis, your organisation will need to include particular wording to say that the group is prevented from distributing profits or assets for the benefit of members – both while the organisation is operating and when it winds up.

The Australian Taxation Office (ATO) has published suggested wording for the two major clauses for an organisation's constitution to indicate that the organisation is not-for-profit:

Example ATO non-profit clause:

'The assets and income of the organisation shall be applied solely in furtherance of its above-mentioned objects and no portion shall be distributed directly or indirectly to the members of the organisation except as bona fide compensation for services rendered or expenses incurred on behalf of the organisation.'

Example ATO winding up clause:

'In the event of the organisation being dissolved, the amount that remains after such dissolution and the satisfaction of all debts and liabilities shall be transferred to another organisation with similar purposes which is not carried on for the profit or gain of its individual members.'

It is important to include this exact wording in your organisation's constitution or rules (or similar wording carefully drafted by a lawyer or accountant). This is because it is the wording that will be recognised and accepted by many government departments, regulators and grant-makers when your organisation applies for government concessions or for funding.

Related resources

Related Pilchconnect resources

PilchConnect Checklist: Questions about your group?

Related links

For online legal information resources for Victorian community organisations about starting a not-for-profit group see: www.pilch.org.au/beforeyoustart