

Fact sheet: What is 'incorporation' and does our group need to incorporate?

Overview

This fact sheet is for not-for-profit groups in Victoria who want to know more about incorporation.

It is a good idea for all not-for-profit groups to think about and decide whether or not to 'incorporate'. This is one of the big legal decisions you will face as a group. It is a particularly important issue for people who are (or have been approached to be) involved on the board or committee of management of the group, or who have decision-making functions in the group.

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 and organisations resident in, or affected by, the laws that apply in Victoria, Australia and is current at 1 October 2008.

What does it mean to 'incorporate'?

All not-for-profit community groups will have some kind of structure, that is, arrangements between the people in the group about how the group operates.

These arrangements may include things like how the group makes decisions, what kind of activities the group undertakes, and how the group manages money. These arrangements are made (sometimes formally and sometimes informally) when a group starts and as it develops. These arrangements are generally private arrangements made between and understood by the people involved in the group.

However, as the group is a private arrangement, anyone outside the group will not know or understand how the group operates. So, if the group seeks donations of money or grants, potential donors or funders will not know how the group plans to manage or spend its money. If the group wants to lease a building to run activities, the owner of the building will not know whether the group is reliable and likely to pay the rent.

Over time, governments have created a number of formal structures (specific arrangements between members of the group) for not-for-profit groups. If not-for-profit groups arrange themselves into one of these formal legal structures, and then register their group with the government, their group becomes, in its own right, recognised by government, the courts, other businesses, and the public, as a formal 'legal entity' or a kind of legal person. This process of setting up as a formal legal structure and registering with the government is known as 'incorporation'.

What are the benefits of incorporation?

There are a number of benefits that come with incorporating a not-for-profit group.

Separate legal entity

The effect of incorporation is that, from the date that the group is 'registered' as an incorporated group, it becomes recognised as a 'legal entity'. This means that the group has a legal 'identity' of its own, separate and distinct from the individuals who formed or make up the group.

Because incorporation means that a group has a separate legal identity, an incorporated group can 'conduct business' in its own name, for example:

- ▶ sign documents and enter into contracts (leases or deeds of agreement);
- ▶ buy, sell, own, lease and rent property and other assets;
- ▶ borrow money; and
- ▶ sue (take legal action in the courts) and be sued (taken to court).

When it does these things, it is the incorporated group that is entering into the contract and the incorporated group that has rights and liabilities under the contract, not the people who make up the group (that is, not the members or the committee).

Having a separate legal identity is a benefit, particularly in terms of the reputation of the group in the eyes of government. Many government grant programs will only give funding to incorporated groups (for more information see www.pilch.org.au/grants). Also, many tax concessions that are available to not-for-profit groups are only available where the group is incorporated (see www.pilch.org.au/tax for more information).

Limited liability

One of the main benefits of incorporating a group is that the group then has 'limited liability'.

'Limited liability' means that in most cases, the responsibility for debts of the group or any legal costs the group may be ordered to pay, is limited to the amount of money and assets held by the group. This helps to protect the people involved in the group from being personally liable if anything goes wrong with the group (that is, from being required to pay any debts or costs from their own money or assets).

Limited liability particularly helps to protect those people who are making decisions for the group, for example, the people who are on the committee of management or board or who are in control of the group.

Beware: You should be aware that there are exceptions to limited liability. The main one is if people in the committee of management or board of the group have acted improperly or unlawfully, particularly in relation to continuing to operate when insolvent (that is, does not have money to meet its debts as they come due). For more information about how committee members or directors may be personally liable see www.pilch.org.au/officeholders.

Also, limited liability will not cover any actions of committee member or directors where they are acting in a personal capacity (for example, if a committee member or director has given a personal guarantee to a bank for a loan the organisation has taken out, then limited liability will not protect that person from liability).

In practical terms, limited liability is a significant benefit:

Example: If an incorporated group enters into a contract to purchase equipment from a business, it is the incorporated group that is responsible to pay the business for the equipment from the group's money. If, for some reason, the group cannot pay for the equipment, then the business will usually only be able to take legal action against the incorporated group for the money owing. This is because the incorporated group is considered to be the 'legal person' that entered in to the contract with the business. The business will not usually have any rights to take legal action against the individual members of the group for the money.

However, if the group that entered into the contract to purchase equipment was not incorporated, then the business would be able to take legal action against the individual people who make up the group. In a group that is not incorporated (an unincorporated group), the individual members of the group – particularly committee members or people who control the group or act on behalf of the group - may be personally responsible for the debts of the group and may have to pay them from their own personal money or assets (i.e. their own bank account or, if the debt is large, selling their own home).

It is also important to be aware that this 'personal liability' may continue even after a person has left the committee (or the group), in relation to acts which took place while they served on the group's committee or acted on its behalf.

Perpetual succession

Another benefit of incorporation is that, because an incorporated group has a legal identity separate to that of the people involved in the group, it will continue to exist (and be recognised by

government, the courts, businesses and the public) even when membership of the group changes. This is known as 'perpetual succession'. In general an incorporated group will last until it is de-registered or 'wound up'.

What are the obligations of being an incorporated group?

While there are benefits to incorporation (for example, limited liability), being an incorporated group also comes with obligations.

Before making a decision to incorporate, your group should consider whether it is able to comply with the costs, requirements and ongoing obligations of being an incorporated group. These take time and mean that people involved in the group need to be willing to take on certain tasks (like organising meetings, and keeping proper financial records). It also means that certain information about your group will or may become publicly available (for example, the names of certain office holders in the group, some financial information and the rules of the group).

While there are specific requirements for each type of structure (for more information see www.pilch.org.au/legalstructure), **in general**, each piece of legislation that sets up incorporated not-for-profit group structures requires groups to:

- ▶ have a name (which sometimes must have the words 'Incorporated' or 'Inc.' or 'Limited' or 'Ltd' after it);
- ▶ have a 'constitution' or a statement of purposes and a set of written rules and that the group agrees to operate by;
- ▶ pay an initial registration fee with the government (which will vary from about \$60 - \$500 depending on the type of structure chosen and where it operates);
- ▶ have a certain number of members and people who are willing to hold certain positions in the group (e.g. on committee of management or as secretary);
- ▶ record the names of members in positions and provide them to government (these details are made publicly available);
- ▶ hold certain meetings and keep certain records;
- ▶ provide the government with financial information about the organisation (money received and spent); and
- ▶ pay an annual fee to government.

As mentioned, the requirements for initial incorporation and the ongoing obligations and reporting requirements vary depending on the type of incorporated legal structure your group chooses and

where, within Australia, it operates. It will also depend on the income and operations of your organisation.

Although these obligations are mandatory (must be done), they are not too onerous. And of course the PilchConnect website and other services and websites are available to help. However, your group should consider whether it can meet these requirements. There is no point in incorporating if no-one in the group is ready to take on any of these tasks.

So, what are the practical things to think about when making the decision whether to incorporate?

Deciding whether or not to incorporate is a decision about assessing risk – you may want to seek legal advice on this decision. If your group decides to stay as an unincorporated group, it should regularly review its position at least every year or if there is a significant change (for example, employing a paid staff member). Also if your group grows and wants to take on further activities or seeks funding, it may wish to re-consider the incorporation decision.

To determine whether your group should incorporate, you should think about the activities your group does now, and the activities it is likely to undertake in the future. The following list may help you to consider just some of the relevant issues:

Possible liability for debts or civil legal actions

- will the activities involve risks where someone - a group member, a volunteer, employee, client or member of the public - could get hurt? (e.g. outdoor activities, the use of equipment, activities involving food or alcohol, protest or campaign activities);
- will your group be entering into an agreement or contract where the group will owe money (e.g. buying equipment, leasing property, taking out a loan or credit)?
- will your group be hiring employees or independent contractors?
- is it possible that your group may need to take legal action against another party and may have legal costs awarded against it (eg. campaign or advocacy groups)?

Incorporation, for the benefit of limited liability, is one way to protect your group's board or committee members from being personally liable for any compensation, debts, or legal costs that the group may have. Of course, having adequate insurance and a risk management plan is also advisable - see www.pilch.org.au/insurance.

Ownership of goods, equipment and property

- will your group own land or buildings?
- will your group need to own or lease equipment - photocopiers, cars, office furniture?
- will your group own shares or other assets or significant amounts of money?

Because an incorporated group can own goods and property in its own name, it is very clear which property the group owns. In contrast, when a group is not incorporated, the question of ownership of property can sometimes be unclear because group members often have to own property 'on behalf of the group' or 'on trust' for the group.

Also, because an incorporated group can own property in its own right, there is not the need to record changes of property ownership as the membership of the group changes. In contrast, an unincorporated group may need to transfer ownership or trusteeship of property from old members to new members (which may attract a fee or tax).

Reputation / seeking grants or funding opportunities

- will your group be looking for funding through grants from government or other private philanthropic funders?
- will your group need insurance?
- will your group be looking to attract members to its committee of management?
- will your group be looking to hire employees?

Being incorporated means that the group has office holders (for example, a secretary and a treasurer etc.), operates in accordance with rules, holds meetings and provides financial information to government. Often this formal legal structure may work to enhance the reputation of your group in the eyes of others.

Your group should check the eligibility requirements of any organisations that it may seek funding from, to see whether incorporation is a requirement. Many government bodies and private organisations that provide funding to not-for-profit community groups, only fund incorporated groups. (There may also be other requirements to receive funding, however often incorporation is a minimum requirement).

Tip: There are some local government funding, private funding, small grant funding programmes that don't require incorporation. There are also ways that an unincorporated group can receive funds, by having an incorporated organisation receive and hold the funds on their behalf (see www.pilch.org.au/auspicing).

Undertaking certain activities

The government requires that, to undertake some activities, a group needs to be incorporated. For example, there is State and Commonwealth legislation in the housing, aged care and some other fields that requires groups working in those fields to be incorporated.

OK, so we have decided we need to incorporate – what next?

If your group decides to incorporate, the next decision is to choose an incorporated structure that suits your group's aims and activities. There are a number of incorporated legal structures that are suitable for Victorian not-for-profit organisations. The Pilchconnect website provides information on some of the more common ones, like becoming an incorporated association or a company limited by guarantee, as well as others. (For more information see www.pilch.org.au/legalstructure).

OK so we have decided NOT to incorporate – what next ?

If your unincorporated group chooses not to incorporate (that is, to stay unincorporated), the main effect of this is that the group will not be recognised as a 'legal entity' and will not have the benefits of limited liability and perpetual succession as explained above.

Some of the benefits of not incorporating are:

- ▶ the group can remain informal and doesn't have to hold meetings in a specific format (although it still can have rules or a constitution to govern these matters);
- ▶ the group doesn't have to register with government or tell government or the public about who its members are or what its financial situation is; and
- ▶ the group doesn't have to pay any registration or annual fees to government;

Remaining unincorporated will not prevent the group from carrying on its day to day activities in the same way that an incorporated group might. Your group can still have a formal set of operating rules (a constitution), hold meetings and issue statements about its financial dealings. It can also take out insurance to try to protect it from possible liability (although insurance may be more difficult to get).

Also, unincorporated groups will still have legal obligations, and will need to comply with employment law, occupational health and safety law, tax law and a range of other laws that apply to unincorporated bodies as well as incorporated bodies.

In fact, many people in the community will not be able to see any difference between an unincorporated group and an incorporated one. However, be aware that while incorporated and unincorporated groups may look the same from the outside, in the eyes of the law there is a vast difference, and if something goes wrong, the courts will treat the two organisations very differently (see limited liability above).

Tip: Deciding whether to incorporate is a decision about assessing risk – you may want to seek legal advice on this decision. And, it is a good idea to regularly review this decision as your organisation changes and grows. If your organisation starts to take on further responsibilities or higher risk activities, or seeks further funding, it can decide to incorporate at any time.

Related Resources

Related Pilchconnect resources

PilchConnect fact sheet: Which incorporated legal structure should we choose?

PilchConnect fact sheet: Incorporated association or a company limited by guarantee?

Related legislation

Associations Incorporation Act 1981 (Vic)

Corporations Act 2001 (Cth)

Related links

For online legal information resources for Victorian community organisations about incorporation see: www.pilch.org.au/incorporation