

1.2 FORMATION

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FORMATION

Before selecting a structure: issues to consider

[1.2.100]

Before selecting a legal structure for a Not-for-Profit Organisation (NFP) it is worthwhile asking the persons wishing to establish the NFP (the promoters) several questions. These questions should be designed to inform the selection of the legal structure and to anticipate any issues that may arise in the future as a consequence of that legal structure. Some issues that may be useful to discuss are listed below. See also the Pre-formation Checklist at Ch 1.1 ([1.1.101]).

[1.2.101] Understanding the intentions of your client

It is important to discuss the intention of the client who wishes to establish the NFP. Quite often it is the case that the client has been personally affected by an issue and wishes to do some good to address it. It may be that a client's wish can be satisfied by abandoning their plans to establish a NFP and instead, for example, take an active role with an existing NFP, or helping to raise funds on behalf of an NFP. There are over 600,000 NFPs in Australia¹.

For example NFP's such as the Royal Children's Hospital Foundation in Melbourne and the Red Cross routinely need persons to assist them with fundraising appeals.

Despite the observations above, it may be unlikely that a client will be dissuaded from their desire to establish a new NFP. But at least, by discussing alternatives to establishing a new NFP, clients will develop a better awareness of the challenges ahead and the choices they are making.

Next, clients need to consider how their "good intentions" to do something to address a particular social issue, will be expressed in reality. That is, what does a client actually want to do and how will this be achieved? Maintaining a NFP on a viable basis is arguably fraught with the same challenges as establishing a for profit business. There are many good books and some courses available on business planning for a NFP.

Sometimes a client's intentions can be confused, or there may be several intentions. For example, a client may wish to establish a NFP to address a social issue but also for the purpose of giving the client a source of employment in that NFP. Whilst these intentions are not mutually exclusive, management of potential conflict of interest is necessary.

¹ Productivity Commission 2010, *Contribution of the Not-for-Profit Sector* (Research Report, Canberra) pp 57-58.

[1.2.102] Location of activities and future plans

The location of activities in a particular Australian jurisdiction or outside of Australia may affect the type of legal structure eventually chosen.

For example, if the clients wish their NFP to operate Australia wide, then the use of an association or non-trading co-operative incorporated under state jurisdiction may be too restrictive. Due to the operation of Pt 5B.2 of the *Corporations Act 2001* (Cth) the association may then need to become a "registrable Australian body" and obtain an Australian Registered Body Number (ARBN). Part 5B.2 requires a body to obtain an ARBN where the body is "carrying on a business" in one or more states other than its own jurisdiction. In these circumstances a company limited by guarantee may be the less complicated option.

If the clients wish to conduct some of the NFP's activities overseas, they may need to consider the type of structure and how it will distribute income overseas. This is primarily due to the

impact of federal taxing statute (see [1.2.107]). Some structures permit distribution of some income overseas whilst others permit distribution of all income overseas.

It may be necessary to consider succession issues, ie what is in place to provide for a handover to others when the client eventually leaves the NFP. Addressing succession issues in the establishment phase may help to ensure NFP longevity and avoid painful departures.

For example, the client who establishes a private charitable trust with a corporate trustee may anticipate younger family members assuming a role on its board of directors. This may be achieved by a simple rotation of directors.

The client could provide in their Will for the transfer to another family member of the nominal share the promoter holds in that corporate trustee.

The option of a corporate trustee may be preferable to the situation where individuals act as trustees and their resignation and appointment of new trustees needs to be given effect by arguably, the more cumbersome process of a deed of appointment.

[1.2.103] Types of activities

Despite arguments in the NFP sector that it is the “purpose” of the NFP and not its “activities” that count, the fact is that “activities” are taken into account by the courts and the Australian Tax Office (ATO) when assessing the “purpose” of an NFP¹.

Hence the type of activities the clients are intending their NFP to undertake will have a bearing on the legal structure. This is because the legal structure invariably will need to accommodate these activities under some form of “purpose” described in its objects and elsewhere in its constituent document.

For example, if the promoter is considering an NFP to protect the environment, the NFPs constituent documents will need to be drafted taking into account s 30-265(1) of the *Income Tax Assessment Act 1997* (Cth) in relation to “registered environmental organisations”. As a registered environmental organisation the NFP will be able to undertake activities outside Australia under those provisions.

¹ *Federal Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204 at [24]. Tax ruling TR 2011/D2, para 29.

[1.2.104] Likely beneficiaries

The persons or entities (the beneficiaries) who are likely to be assisted by the NFP needs to be considered (we use the term “beneficiaries” to describe these persons and entities, although the technical meaning of the term applies only to persons who benefit from a charitable trust).

Answers to these questions might help in selecting the jurisdiction in which the legal structure is to operate, design of the “objects” in the NFPs constituent documents and also the wind up clauses.

For example, both public and private ancillary funds can only assist beneficiaries that are deductible gift recipients endorsed under item 1 of the table in s 30-15 of the *Income Tax Assessment Act 1997*.

Hence it is important that clients are aware of potential restrictions that their NFP may face in assisting beneficiaries. For some clients such restrictions may be fatal to their NFP plans. There is also a risk the limitations are misunderstood.

TIP 

ATO compliance review 2010

In its reviews and audits of private and public ancillary funds in 2010, the ATO identified common errors by trustees, which include:

- distributions paid directly to entities located offshore;
- benefits provided to non-DGRs located in Australia; and
- distributions to other ancillary funds, ie distributions to “item 2” and not “item 1” entities.

[1.2.105] Sources of NFP revenue

This issue has two points. Firstly asking the “money” question will help to identify initial viability of the NFP. Occasionally clients of NFPs are so focussed on getting “the legals” correct or establishing their website that they fail to consider how their NFP will survive financially.

Secondly, identifying NFP sources of revenue will also help to select and draft its legal structure. Contrary to some perceptions, deductible gift recipient (DGR) endorsement is not the pinnacle of achievement. DGR endorsement entitles a NFP to issue tax deductible receipts for the donations it receives. But some NFPs may simply not be need donations. It depends on the NFPs expected revenue sources. For example, a discretionary trading trust/charitable trust structure operates by providing for charitable giving using tax free *income*.

TIP 

The discretionary trust/charitable trust giving structure

A discretionary trust gives its trustee discretion as to whom among the trust beneficiaries will receive trust income and how much they will receive. Discretionary trusts are commonly used for family or trading trusts.

If all trust income is distributed prior to the end of the financial year the income is taxed in the hands of the beneficiary, at the tax rate applicable to that beneficiary. If a beneficiary is an income tax exempt entity, no income tax is paid on distributions it receives from the discretionary trust.

Typical tax exempt beneficiaries are religious, educational and poverty relief institutions or charitable trusts established by the family who operate the discretionary trust.

The beneficiary does not need to be able to receive tax deductible donations. As long as the beneficiary is tax exempt, then no tax is paid on the distribution it receives.

This structure can effectively increase the level of giving by the family members because no tax is paid. That is, family members give not by using their post-tax distributions received from the discretionary trust, but the gross untaxed distributions directly from that trust to a charitable beneficiary.

In any event, if the only revenue source for the charity is “income”, not donations, then DGR endorsement is not needed.

[1.2.106] A need for several structures – subsidiary entities

It may be there is a need to have several NFP structures, comprising parent and subsidiary entities or an entity acting as trustee for several trusts. There can be several reasons for structuring, including:

- managing and isolating risk;
- separating governance and management functions;
- different branding; and
- different purposes, particularly bearing in mind NFP taxation concessions that require an NFP to have “sole or dominant” purpose.

For example, faith based NFPs are constituted generally as charities because they have, as their main purpose, the advancement of religion. However, members of these NFPs may also wish to address the suffering of the poor in countries other than Australia by seeking admission to the Overseas Aid Gift Deduction Scheme (OAGDS). The OAGDS entitles a NFP to tax deductibility of donations.

However a criterion for admission to the OAGDS is that the NFP be established for the purpose of providing “relief and development”. A NFP cannot be admitted to the OAGDS if its purpose is to advance a religion. Hence a faith based NFP may need to set up a subsidiary NFP entity which will undertake the OAGDS development and relief work.

A subsidiary entity must not be assumed to mean an entity that is smaller than the parent entity. The term “subsidiary” in the *Corporations Act 2001* is defined as being an entity that is “controlled” by the parent entity. Control is defined by the parent entity as being in the position to cast more than one-half of the maximum number of votes at a general meeting, or controlling the composition of the subsidiary entity’s board¹.

Because companies limited by guarantee (CLGs) require only one member, they are an ideal structure to act as a not-for-profit subsidiary for another NFP entity.

A NFP may wish to establish a separate trading entity in order to isolate risk and governance. A commercial enterprise by a NFP for example, may involve risks that the NFP itself does not wish to be exposed to. The scale of the enterprise may also mean the need for a dedicated management team to run that commercial enterprise. These can all be reasons for a NFP to establish a separate trading entity such as a proprietary limited company.

¹ *Corporations Act 2001*, s 46.

[1.2.107] Impact of taxing statutes

It is a truism to say that NFPs are “mission driven”. Bearing that truism in mind, taxing statutes can have an impact on the final shape of that mission. For example, the *Income Tax Assessment Act 1997* has specific requirements for DGR endorsed organisations under Div 30 and income tax exempt entities under Div 50. These requirements impact on the:

- purpose of the NFP;
- activities the NFP may undertake;
- potential beneficiaries of the NFP, including whether those beneficiaries may be outside of Australia;
- whether the NFP can receive in specie bequests free of capital gains tax;
- whether passive investments will entitle the NFP to franking credits on dividends; and
- whether employees of the NFP may be able to salary sacrifice using the fringe benefits tax rebates and exemptions amongst other things.

Particular taxation statutes that may need to be taken into account when considering structures may include:

- *Income Tax Assessment Act 1997*;

- *Income Tax Assessment Act 1936* (Cth);
- *Fringe Benefit Tax Assessment Act 1986* (Cth);
- GST Act;
- State Duties Acts;
- State Payroll Tax Acts; and
- associated tax and revenue rulings relevant to an Act.

Taxation of NFPs is discussed further in Ch 5.1.

Selecting a legal structure: companies limited by guarantee

[1.2.200]

[See [1.2.3001] for a model *Company Limited by Guarantee: Constitution*]

[1.2.201] Overview

History

Historically, companies limited by guarantee (CLGs) were developed so that non trading associations could gain the advantage of incorporation and limited liability. The “guarantee” refers to an undertaking by members to contribute a defined amount to the debts of the CLG should the CLG be wound up.

There are now 11,700 CLGs in Australia. Of these, 70% have revenue of less than \$1M per year¹.

The law

CLGs are regulated by the *Corporations Act 2001*. For convenience, the *Corporations Act 2001* will be referred to in this section as the Act.

Other regulations include the *Corporations (Review Fees) Regulations 2003* (Cth) and ASIC Class Orders *CO 02/184* and *CO 04/1569* in relation to exemptions for CLGs from fundraising provisions under the Act.

A CLG is a public company as distinct from a private proprietary limited company. Hence requirements under the Act that apply to public companies generally apply to CLGs.

Modern function

CLGs are typically used in NFP sector for organisations operating across state jurisdictions. This is because associations incorporated under state legislation face difficulties if they wish to conduct substantial business in several jurisdictions.

In the past CLGs were perceived as being subject to greater regulation than incorporated associations. This argument is less cogent today as some CLGs can escape company reporting requirements, and incorporated association committees now tend to have similar duties as company directors.

Surprisingly, until 28 June 2010 CLGs, were permitted to pay dividends to members, unless there was a prohibition to do so under the CLGs constitution. However, the Act has been amended to now require CLGs to prohibit such payments. The amendments in effect create a statutory “non-distribution clause”, an essential feature of NFPs.

Because members do not contribute share capital to the CLG, funds needed to operate the CLG must be raised by other means. Nor can the guarantee be used to secure a loan; unlike a fully paid share the amount guaranteed is not an asset of a CLG².

Examples of well known CLGs are World Vision Australia and Bush Heritage Australia.

- 1 Productivity Commission 2010, *Contribution of the Not-for-Profit Sector* (Research Report, Canberra) pp 57 – 58
- 2 See *Re Irish Club Company* [1906] WN 127.

[1.2.202] Definition and characteristics

Under s 9 of the Act a “company limited by guarantee” means, a company formed on the principle of having the liability of its members limited to the amount that the members undertake to contribute if the CLG is wound up. The amount of the guarantee is typically very small (eg \$50) and it must be specified in registration with ASIC.

CLGs do not have share capital¹.

In June 2010, the Australian Government introduced differential financial reporting for CLGs. Significantly that Act now defines a “small CLG”. Amongst other things, a small CLG has revenue of less than \$250,000 per annum².

Financial reporting is further discussed in [Ch XX].

- 1 *Corporations Act 2001*, s 124.
- 2 *Corporations Act 2001*, s 45B.

[1.2.203] Directors, secretary and members, and auditor

Directors

A CLG must have at least three directors of which at least two must ordinarily reside in Australia. A person must give their signed consent before they are appointed as a CLG director.

Persons disqualified from managing corporations or who are under the age of 18 may not be appointed as a director¹.

The duties of directors are extensive; conscientiousness on the part of a director is not sufficient to avoid prosecution as the case below shows.

Example: Australian Securities and Investments Commission v Healey

This case concerned action against certain directors of a for profit company under s 180(1) of the Act. This section of the Act requires directors or other officers of a company to discharge their duties with the degree of care and diligence that a “reasonable person” would exercise.

Middleton J summarised that directors duties include:

- having a rudimentary understanding of the company business and its business fundamentals;
- keeping informed about company activities (whilst not required to have a detailed awareness of day-to-day activities, a director should monitor company affairs and policies);
- being familiar with company financial status by regular review and understanding of financial statements; and
- having a questioning mind.

The 2007 annual reports of the companies in which the directors served failed to disclose significant matters. In summing up, Middleton J stated that he considered the directors to be intelligent, experienced and conscientious people. His Honour further stated that there was no suggestion that each director did not honestly carry out his responsibilities as a director.

Despite His Honour's observations, Middleton J found that the directors had contravened s 180(1).

Directors' main statutory duties of care can be found in the *Corporations Act 2001*, however duties may also be found in the common law and a particular CLGs constitution².

See generally RP Austin and IM Ramsey, *Fords Principles of Corporations Law* (12th ed, LexisNexis Butterworths, 2005) p 375ff³.

Secretary

A CLG, as a public company, must have at least one secretary who must ordinarily reside in Australia. The secretary must give their signed consent before they are appointed⁴.

A director may be a secretary. However, it is the directors who appoint a person to be the secretary⁵.

Section 188 of the Act requires the secretary to ensure the company complies with certain obligations including the maintenance of a registered office, keeping the registered office open to the public, and corresponding with ASIC.

A person who is not entitled to be a secretary unless: they are over the age of 18; are not disqualified from managing companies; and give their consent to act as a secretary⁶.

Members

All companies including CLGs must have at least one member. CLG members must state the amount of the guarantee that they agree to in writing before registration⁷.

The Act requires a member's name to be entered onto a register of members. The member's name and their address, in addition to the date on which entry of their name was made into the register, must be disclosed.

A person is deemed to be a member of a CLG when their name is entered on the register of members. Hence a person is not entitled to membership rights, such as voting rights, until their name is entered on the register⁸.

Auditor

A registered company auditor must still be appointed for all CLGs including "small CLGs", within 1 month of the CLGs registration. Small CLGs are not required to produce audited financial reports. Hence if a CLG is a "small CLG" the Act effectively requires it to have on the one hand, an auditor but on the other, not be required to produce audited financial reports⁹.

Registered company auditors in practice may be difficult to locate. A person who is a Chartered Accountant or Certified Practising Accountant is not necessarily a registered company auditor. Such professionals are a good place to start to locate a registered company auditor.

¹ *Corporations Act 2001*, ss 201A, 201B, 201C, 201D and 204.

² *Corporations Act 2001*, s 180.

- 3 *Australian Securities and Investments Commission v Healey* [2011] FCA 717.
- 4 *Corporations Act 2001*, s 204A(2)
- 5 *Corporations Act 2001*, s 204D.
- 6 *Corporations Act 2001*, s 204
- 7 *Corporations Act 2001*, ss 114 to 121
- 8 *Corporations Act 2001*, ss 169 and 231.
- 9 *Corporations Act 2001*, s 327A.

[1.2.204] Registered office

As a public company, a CLG must have a registered office. The registered office must be open to the public for least three hours each business day.

A CLG must display its name prominently at its registered office, in addition to any other place where it carries on its business that is open to the public¹.

¹ *Corporations Act 2001*, ss 142 to 145.

[1.2.205] Registration of company limited by guarantee

Under s 119A of the Act a CLG must be registered in a particular state or territory in Australia. The effect of this registration is to permit the state or territory to impose additional obligations on the CLG. For example, there may be state duties on CLG land transactions (unless the CLG is exempt).

The process for registration is found under ASIC Form 201. This form is a generic company registration form. Section 5 of the form deals with shares and should not be completed.

A copy of the CLG constitution must be lodged with the application.

A CLG may be registered without the word “Limited” in its name, or alter its registration of the CLG to the same effect. Some NFPs may wish to do this to say, avoid a perception that their CLG is “commercial”.

Deleting the word “Limited” from a CLG’s name is only possible if the CLG constitution:

- requires the CLG to pursue charitable purposes only and apply its income to promoting those purposes;
- prohibits the CLG making distributions to its members and paying fees to its directors; and
- requires the directors to approve all other payments the CLG makes to directors.

¹

ASIC Form 432 must be used where the CLG is to be registered without the word “Limited” in its name. Fees apply.

¹ *Corporations Act 2001*, s 150

[1.2.206] Advantages and disadvantages

Advantages

The major advantage of a CLG is that it may operate in all Australian jurisdictions. Depending on the circumstances, the fact a CLG need only have one member can also be an advantage. Because a CLG cannot distribute dividends to members by law, a CLG is an ideal structure of a NFP.

Disadvantages

Relative to small incorporated associations, financial reporting requirements for a CLG (other than the “small CLG”) can be more complex. With modern changes to the Associations Incorporation Acts the differences between the duties of committee members of associations and directors of CLGs are fast disappearing.

Community land trusts**[1.2.301] Overview**

A NFP popular in the USA and UK and now being introduced into Australia is the Community Land Trust (CLT). CLTs try to provide affordable residential housing yet offer residents a real sense of home ownership.

The classic CLT model as developed in the USA involves a NFP holding fee simple to land and entering into long term leases with residents. The model as being developed in Australia permits residents to make improvements to their home and by means of a “reversion formula” embedded in the lease, capture some of the value of those improvements when they end their lease. In addition, the CLT usually undertakes to grant a new lease to specified next-of-kin in the event the resident dies during the term of their lease. The lease term may be 99 years or more.

A peculiar feature of the arrangement is that upon signing their lease, the CLT resident automatically becomes a member of the CLT. To a limited degree this means the resident is also their own landlord. CLTs in Australia may be eligible for tax concessions where they can provide benefits to the public.

A benefit of the CLT lease arrangement is its flexibility. The lease terms can be drafted to include specific clauses relevant to the CLT’s purposes. This may mean for example, that a CLT wishing to promote environmental benefits could introduce obligations on the CLT and resident regarding use of renewable energy and water recycling.

In Australia residential tenancy legislation may affect the design of a CLT lease. Under these circumstances a CLT lease arguably works best in NSW. This is because s 20 of the *Residential Tenancies Act 2010* (NSW) permits flexibility in designing CLT leases to transfer some responsibilities normally associated with home ownership to the resident.

TIP **Drafting a CLT Constitution**

See the Company Limited by Guarantee Constitution at [1.2.3001] for guidance in drafting a Constitution for Community Land Trusts.

Optional clauses in the CLG model constitution illustrate how the generic CLG constitution can be adapted to suit particular types of NFPs. The alternate clauses either replace or are additional to clauses in the generic precedent CLG constitution.

Selecting a legal structure: proprietary limited company

[1.2.401] Overview

At first glance a proprietary limited company would not appear to be a suitable legal structure for a NFP. This is because under the *Corporations Act 2001* a proprietary limited company has the power to issue dividends to its shareholders and distribute assets to shareholders on its dissolution.

It is possible with effective drafting to effectively override rights of shareholders to prevent the distribution of dividends and assets to shareholders in the NFP constitution. There are examples on the Australian Business Register of NFP proprietary limited companies that are endorsed by the ATO as charitable institutions.

Given the effort required to draft sufficient overriding clauses, and the difficulty that shareholdings are transferable as part of the estate of the shareholder, the use of a proprietary limited company as an NFP may not be worth it.

However, there are two exceptions where a proprietary limited company will be useful for an NFP, namely:

- as a NFP subsidiary trading entity; or
- as a corporate trustee.

[1.2.402] Subsidiary trading entity

A NFP may invest by way of shareholding in a commercial entity. In addition to receiving dividends, the NFP (if it is charitable) may be entitled to claim the franking credits from those dividends.

That commercial entity could be proprietary limited company wholly owned by the NFP. That is the NFP may be the sole shareholder in that proprietary limited company. A proprietary limited company need only have one director and shareholder.

See the discussion on subsidiary entities at [1.2.106].

[1.2.403] Corporate trustee

A proprietary limited company can also be useful for an NFP wishing to establish itself as a corporate trustee of a charitable trust. The corporate trustee can be useful because:

- directors of the trustee can be replaced through a simple appointment and resignation process rather than a deed of appointment; and
- shareholdings in the corporate trustee can be transferred to family members (a feature particularly important for private charitable trusts and their succession planning in families).

The corporate trustee is also mandatory for private ancillary funds. Private ancillary funds and charitable trusts are discussed further at [1.2.701].

Establishing a proprietary limited company is a relatively straightforward and well known process. For that reason we will not discuss it further here.

PRECEDENTS

Company limited by guarantee: constitution

[1.2.3001] Company limited by guarantee – precedent

Drafting note: Company limited by guarantee precedent

Drafting a CLG constitution may require additional clauses, depending on governance and membership requirements, or intended tax status. For example, CLGs intending to be entered on the register of environmental organisations or register of cultural organisations are required to have certain clauses in their constituent documents.

In particular, clauses will be required to comply with ATO requirements for DGR endorsement and revocation of “public funds”.

The standard ATO “DGR public fund revocation and windup clause” is:

If the fund, authority or institution is wound up or the endorsement (if any) or the organisation as a deductible gift recipient for the operation of the fund, authority or institution is revoked, any surplus assets of the gift fund remaining after the payment of the liabilities attributable to it, shall be transferred to a fund, authority or institution to which income tax deductible gifts may be made

1

It may be useful to state that directors have power to approve bylaws. This is to help avoid a contest that the bylaws do not form part of the statutory contract binding members to the company.

Additional clauses may be needed if the CLG wishes to be registered without the word “Limited” in its name: see [1.2.205].

Community Land Trusts – optional clauses

This CLG Constitution contains optional clauses for Community Land Trusts based on the “Model Classic Bylaws” developed for CLTs in the USA (see also [1.2.301] for an overview of CLTs).

Optional clauses and drafting notes are provided for clauses 1.2, 2.1, 2.2, 2.6, 2.7, 5.1, 5.2, 4.3, 4.6, 4.7, 4.8, 5.7 and 5.9.

1 Preliminary

1.1 Exclusion of replaceable rules

The replaceable rules contained in the Act do not apply to the Company.

1.2 Definitions and interpretation

In this Constitution:

- (a) “Act” means the *Corporations Act 2001* or any statutory modification or re-enactment thereof for the time being in force.
- (b) “Board” means the board of directors for the time being of the Company.
- (c) “the Company” means [legal name].

- (d) “Directors” means the directors for the time being of the Company.
- (e) “Guaranteed Amount” means the amount set out in clause 1.6.
- (f) “Member” means member of the Company.

**Optional clause – Community Land Trusts (definition of
“Member”)**

- (a) “Member” means a person whose name is entered in the Register either as a:
 - (i) Lessee Member; or
 - (ii) General Member
- (b) “Lessee Member” means a person who leases land or housing from the Company.
- (c) A “General Member” means a person, 18 years of age or older who is admitted by the Board of the Company as a member under the process described in clause [XXXError! Reference source not found].

Note: CLTs generally wish to encourage a wide community support base, in addition to encouraging persons to enter into leases. CLTs achieve this goal by specifying different membership classes such as “Lessee Members” and “General Members”.

- (g) “Officer” has the same meaning of that term as defined in s 9 of the Act.
- (h) Principal Purpose has the same meaning of that term as defined in s 1.3.
- (i) “Seal” means the common seal of the Company (if any).
- (j) “Secretary” means the secretary for the time being of the Company and if there are joint secretaries, any one or more of such joint secretaries.
- (k) Except so far as the contrary intention appears in this Constitution, an expression has, in a provision of this Constitution that deals with a matter dealt with by a particular provision of the Act, the same meaning as in that provision of the Act.
- (l) Words importing one gender are deemed to include all genders and the singular to include the plural and the plural the singular unless the contrary is expressly provided.

1.3 Principal Purpose

- (a) The Principal Object for which the Company is established is to [insert Principal Purpose].
- (b) Solely for the purpose of furthering the Principal Purpose, the activities the Company may undertake are:
 - (i) [insert activities]; and
 - (ii) undertake such other incidental activities it considers will support of the Principal Object.

Drafting note: s 1.3 Principal Purpose

The Act does not require a CLG constitution to include an “objects” clause however in practice, most CLGs will require one. The objects clause establishes and states the reason for the existence of the CLG. The clause will be required if the CLG intends to apply to the ATO for tax concessions or DGR endorsement.

It is worth noting the statement by the High Court in the *Word Investments Case* that a requirement to find a “true, main, dominant or paramount purpose” and powers subserving the main purpose applies “precisely” to entities that have an “objects” clause².

Hence it is worth giving some consideration to describing the “paramount purpose” of the CLG in its objects.

In addition, it is useful to separately specify from the principal purpose, the activities that the CLG may undertake in furtherance of that principal purpose. This will give the CLG board and members and supporters an indication of what the CLG actually does. Importantly it will also give the ATO and other government agencies an understanding of the CLG’s activities to help assess its entitlement to tax concessions.

1.4 The Principal Purpose is charitable.

1.5 Application of income and property

- (a) The income and property of the Company must be applied solely towards the Principal Purpose.
- (b) No portion of the profits, income or property of the Company may be paid or transferred directly or indirectly to Members by way of dividend, bonus or otherwise.
- (c) Payment may be made in good faith to any member of the Company:
 - (i) in return for any services actually rendered to the Company;
 - (ii) for goods supplied in the ordinary and usual way of business;
 - (iii) by way of interest on money borrowed from any member of the Company at a rate not exceeding the rate for the time being fixed by the Board; and
 - (iv) of reasonable and proper rent for premises demised or let by any member of the Company.
- (d) A Director may not be paid directors fees for serving as a director but payments may be made to directors in the following circumstances:
 - (i) for the payment of out-of-pocket expenses incurred in carrying out the duties of a director where the payments do not exceed an amount previously approved by the Board; or
 - (ii) for any service rendered to the Company in a professional or technical capacity where the provision of that service has the prior approval of the Board and the amount payable is approved by a resolution of the Board and is on reasonable commercial terms; or
 - (iii) as an employee of the Company where the terms of employment have been approved by a resolution of the Board.

Drafting note: s 1.5 Application of income and property

This section incorporates the standard ATO non-profit clause which is³:

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.

The section of the precedent also permits payment to members and directors for reimbursement of out of pocket expenses and services rendered in a professional capacity to the CLG.

It is worth considering s 191 of the Act relating to disclosure of interest by directors. That disclosure should be recorded in minutes of the CLG board meetings, where payments may be made to directors or members for out of pocket expenses or for services rendered.

Arguably, with the changes to the Act that prevent a CLG from distributing dividends, a “non-profit” clause is no longer needed in a CLG constitution. However such a clause remains useful because it may help to remind CLG members and directors of the Act’s restrictions and may prevent difficulties at the ATO if the CLG seeks tax concessions as an NFP.

1.6 Liability of members

The liability of the Members is limited to the Guaranteed Amount, being \$50.00.

Drafting note: s 1.6 Liability of members

Members of a CLG undertake to provide the CLG with a certain sum in the event that the CLG is unable to meet claims of its creditors⁴.

Note that liability to pay the guaranteed amount rests with:

- persons who are members at the commencement of the winding up; and
- (where those persons are unable to meet the CLG’s liabilities), persons who have been members within a year before commencement of the winding up.

There are some exceptions to this latter requirement (see Pt 5.6, Div 2 of the Act). The past members are liable only to contribute towards the CLG’s outstanding debts incurred before they ceased to be a member.

In practice the amount of the guarantee is nominal such as \$50. Given the insistence by financial institutions for directors to provide personal guarantees for a loan to a CLG, it may be worth considering increasing the members guarantee to a more substantial amount.

1.7 Distribution of assets on revocation of endorsement

- (a) Where the endorsement of the Company as a deductible gift recipient is revoked by the Commissioner of Taxation, the following assets remaining after satisfying the Company’s liabilities and expenses must be transferred to such other institution or institutions in Australia to which income tax deductible gifts may be made:
 - (i) Gifts of money or property for the Principal Purpose;
 - (ii) Contributions made to an eligible fundraising event for the Principal Purpose; and
 - (iii) Money received by the Company as a consequence of those Gifts or Contributions.

The identity of the institution or institutions will be decided by the Members by ordinary resolution as near as practicable following receipt of a notice of revocation from the Commissioner of Taxation. If the Members fail to decide, the public benevolent institution shall be determined by application to the Supreme Court in the State of incorporation.

1.8 Distribution of property on winding up

- (a) Where on the winding up or dissolution of the Company, there is a surplus of assets after satisfying all the Company's liabilities and expenses, the surplus:
- (i) must not be paid or distributed to Members; and
 - (ii) will be given or transferred to such other institution in Australia to which income tax deductible gifts may be made which:
 - (A) has similar objects to those of the Company as described in this Constitution, and
 - (B) prohibits the distribution of income, profit or assets to its Members.
- (b) Such other institution will be determined by Members by ordinary resolution on or before the time of such winding up or dissolution or in default of determination and consent such institution as determined by application to the Supreme Court of Victoria.

Drafting note: s 1.7 Distribution of assets and revocation of endorsement and s 1.8 Distribution of property on winding up

Sections 1.7 and 1.8 incorporate standard ATO requirements for DGR endorsement of an organisation as a whole. Section 1.7 applies where the CLG may continue to exist but its DGR endorsement is revoked. At this point the CLG must distribute its gifts and contributions to a similarly endorsed organisation.

The standard ATO "DGR revocation clause" is⁵:

If the endorsement of the organisation as a deductible gift recipient is revoked, the following shall be transferred to another organisation to which income tax deductible gifts can be made – any surplus:

- gifts of money or property for the principal purpose of the organisation
- contributions made in relation to an eligible fundraising event held for the principal purpose of the organisation, and
- money received by the organisation because of such gifts or contributions.

Section 1.8 applies where the organisation is wound up. The standard ATO "DGR windup clause" is⁶:

In the event of the organisation being wound up, any surplus assets remaining after the payment of the organisation's liabilities shall be transferred to another organisation with similar objects to which income tax deductible gifts may be made.

The ATO revocation and wind up clauses above apply where the organisation is as a whole, endorsed as a DGR. There are different clauses where an organisation operates a DGR endorsed "public fund" but the organisation itself is not DGR endorsed. See s 2.4(h).

As with the "non-profit" clause, a "wind up" clause may help to prevent disputes arising at a members meeting to wind up a CLG and also to comply with ATO requirements if the CLG seeks tax concessions.

2 Membership

Drafting note: s 2 Membership

A common practice in CLGs with a wide community support base is for the CLG constitution to specify different membership classes. Such classes for example include “full member” and “associate member” classes where for example, the associate member is not permitted a vote at CLG meetings.

Be aware that membership rights may arise not only in a CLG constitution but also by operation of the Act. Hence some care is needed to ensure different membership classes have the rights that drafters have intended. For example, an associate member may still have a right to access CLG board minutes, or rights before a court.

Another common practice is for membership to be confined to persons who are also directors of the CLG.

2.1 Eligibility, application and admission

- (a) Any natural person or corporation (incorporated or otherwise) may apply to become a Member provided:
 - (i) Application for membership is made on the prescribed Application Form and the determined fee has been paid;
 - (ii) The person or corporation agrees in writing to provide a guarantee of not less than the guaranteed amount to defray such liabilities and expenses of the Company upon its winding up or dissolution;
 - (iii) The Application for Membership has been accepted by the Board and such acceptance may be determined by the Board using any criteria as the Board alone may determine; and
 - (iv) The name of the Member has been entered in the Register of Members.

Optional clause – Community Land Trusts (Membership upon execution of lease)

2.1 Lessee Member entitled to Membership upon execution of a lease

- (a) A Lessee Member becomes a Member upon:
 - (i) execution of a lease of land with the Company;
 - (ii) signing an agreement to pay the Guaranteed Amount to defray such liabilities and expenses of the Company upon its winding up or dissolution; and

The entering of the Lessee Member’s name in the Register.

- (b) The Board may decline any application for membership and is not bound to give reasons why the application was not accepted.
- (c) When an applicant has been accepted for membership the Secretary must send to the applicant written notice of their acceptance.
- (d) The first Member shall be the subscriber to this Constitution who shall not be required to apply for membership.
- (e) The minimum number of Members is 1.