

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

Legal information for community organisations

This fact sheet covers:

- what does it mean to incorporate?
 - what are the benefits of incorporation?
 - what obligations do incorporated groups have?
 - what are the practical things to consider when deciding whether to incorporate?
 - we have decided to incorporate, what's next? and
 - we have decided *not* to incorporate, what's next?
-

It is a good idea for all not-for-profit groups to think about and make a decision on 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.

What does it mean to 'incorporate'?

All not-for-profit community groups will have some kind of structure or rules, 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 sometimes formal and sometimes informal.

When these rules or arrangements are made between people involved in the group, people outside the group will not know or understand how the group operates. So, if the group seeks donations of money or grants, potential givers 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 such as incorporated associations or companies. Not-for-profit groups can arrange themselves into one of these formal legal structures, and then register their group with the government. This means 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 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

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 operate in its own name. For example, it can:

- 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 a group 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 go to our [Fundraising page](#)). Also, some tax concessions are only available to not-for-profit groups that are incorporated (for more information go to our [Taxation page](#)).

Limited liability

One of the main benefits of incorporating a group, so that it has a separate legal identity from its individual members, 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 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 of the group from their own money or assets).

In practical terms, limited liability is a significant benefit.

EXAMPLE

GreenTowns is an incorporated association that revegetates areas in South Australia. It enters into contracts in the GreenTowns name to purchase planting equipment from a business.

If, for some reason, GreenTowns could not keep up with its payments for the equipment, then the business would usually only be able to take legal action against GreenTowns for the money owing, and not against any of the members or committee of GreenTowns. This is because GreenTowns is the 'legal person' that entered into the contract with the business.



However, if GreenTowns was not incorporated the equipment contract would have to be in the group members' names. The business would then be able to take legal action for unpaid money against the individual people who make up the group for unpaid money. If a debt is large, this could expose individuals to significant consequences such as needing to sell their own home to pay the debt.

An important exception to understand is that limited liability will not apply to protect individuals if a director or officer of an incorporated group breaches their directors' duties. These are duties prescribed by legislation and case law (judge-made law) and are largely the same whether you are a director of a company or an association. These duties include:

- always acting in the best interests of the group
- being honest and careful in your dealings both with the group and on behalf of the group
- knowing what the group is doing, including how the group is faring financially
- ensuring that the group keeps proper financial records, and
- making sure that the group can pay all of its debts on time.

FURTHER READING

For more information on directors' duties, see the Duties Guide at www.nfplaw.org.au/governance.

EXAMPLE

Sam is a director of GreenTowns. Because he has not been actively keeping up with GreenTown's finances, GreenTown is paying more than it can afford and soon becomes insolvent. If a business takes legal action against GreenTowns for the money owing and GreenTowns does not have enough money to pay, Sam may be investigated by a regulator. If Sam is found to have breached his duty to not trade while insolvent and/or his duty to understand GreenTowns' financial position, then the nature of the limited liability structure of GreenTowns may not fully protect Sam and he may become personally liable.

Directors and officers of a not-for-profit group should be aware of their possible personal liability for breaches of other State or Federal legislation. For example, environmental and work health and safety legislation now often provides that both a company and the directors or persons concerned in its management will be guilty of offences committed by the group regardless of any active involvement.

Directors and officers should seek further professional (including legal) advice if they are unclear about their obligations, liability or directors' duties owed to the group.

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 obligations do incorporated groups have?

There are many benefits to incorporation, including limited liability and the potential to access additional government funding and tax concessions. However, being an incorporated group also comes with obligations.

Before making a decision to incorporate, your group should consider whether it can 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 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, and where state or territory based, these are slightly different (for more information go to our [Legal Structures](#) page). 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 set of written rules with purposes that the group agrees to operate in accordance with
- pay an initial registration fee to the relevant state, territory or federal government (between \$40 and \$1,100)
- have a certain number of members and people who are willing to hold certain positions in the group (eg 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.

The ongoing obligations and reporting requirements vary depending on the type of incorporated legal structure your group chooses and on the income and operations of your organisation and whether or not your organisation is also registered as a charity with the Australian Charities and Not-for-profits Commission.

The Not-for-profit Law [Information Hub](#) can help you meet your ongoing obligations. However, there is no point in incorporating if no-one in the group is ready to take on any of the tasks required.

What are the practical things to consider when deciding whether to incorporate?

Deciding whether or not to incorporate is often a decision about assessing risk – you may want to seek legal, accounting or other professional 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, if it employs a paid staff member, received a large grant, or wants to lease property). Also, if your group grows and wants to take on further activities or seek 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 checklist may help you to consider just some of the relevant factors.

Possible liability for debts or civil legal actions

Incorporation, for the benefit of limited liability, is one way to protect your group's board or committee members from being personally liable for compensation, debts, or legal costs that the group may have. If any of the points below apply to your group, you should consider incorporation.

- Will the activities involve risks where someone – a group member, a volunteer, employee, client or member of the public – could get hurt (eg outdoor activities, the use of equipment, activities involving food or alcohol, protest or campaign activities)?
- Could the activities of the group harm someone's reputation (eg possible defamation when advocating or campaigning about a particular issue)?
- Will your group be entering into an agreement or contract where the group will owe money (eg 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 will need to take legal action against another party and may have legal costs awarded against it (eg campaign or advocacy groups)?

Of course, having adequate insurance and a risk management plan is also advisable – for more information go to our Risk and Insurance page at www.nfplaw.org.au/riskinsurance.

Ownership of goods, equipment and property

Because an incorporated group can own goods and property in its own name, it is very clear which property is owned by the group. In contrast, when a group is not incorporated, there may be difficulties opening bank accounts, problems with insurance, and confusions about property ownership (including intellectual property such as logos or website content) since group members often have to own property 'on behalf of the group' or 'on trust' for the group.

If the points below apply to your group, you should consider incorporating.

- Does your group need to open bank accounts or take out insurance?
- 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?

An incorporated group can own property in its own right. They do not need to record changes of property ownership as the membership of the group changes. In contrast, people in an unincorporated group may need to transfer ownership or trusteeship of property from old members to new members (which may attract a fee or have tax consequences).

Reputation / seeking grants or funding opportunities

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

- 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 hire employees?

Your group should look up the eligibility requirements of 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. However, there may also be other requirements in order to receive funding, such as having a certain tax status such as being endorsed as a Deductible Gift Recipient.

TIP

There are some local government funding, private funding, and small grant funding programs 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 (for more information go to our Information Hub page on Auspicing at www.nfplaw.org.au/auspicing).

Undertaking certain activities

The government requires that, to undertake some activities, a group needs to be incorporated, for example for some types of housing, aged care, native title and some other fields.

We have decided to incorporate, what's next?

If your group decides to incorporate, the next decision is to choose an incorporated structure that suits your group's aims, direction and activities. There are a number of incorporated legal structures that are suitable for Victorian not-for-profit organisations. The Not-for-profit Law Information Hub provides information on some of the more common structures like incorporated associations in various states and territories, and a company limited by guarantee, as well as others (for more information go to our page on Legal Structures at www.nfplaw.org.au/legalstructure).

We have decided *not* to incorporate, what's next?

If your unincorporated group chooses not to incorporate (that is, to stay unincorporated), your 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 its financial situation, 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 or more expensive to get when unincorporated).

Also, unincorporated groups still have legal obligations, and will need to comply with employment law, occupational health and safety law, consumer law, tax laws and a range of other laws.

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 often 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.



Resources

Not-for-profit Law Resources

▀ [Choosing a legal structure](#)

This page lists the various types of not-for-profit legal structures, allowing you to determine the best structure for your group.

▀ [Governance and directors' duties](#)

This page outlines contains information, links, and fact sheets on directors and officers' duties of governance in organisations.

A Not-for-profit Law Information Hub resource. Access more resources at www.nfplaw.org.au

© 2015 Justice Connect. You may download, display, print and reproduce this material for your personal use, or non-commercial use within your not-for-profit organisation, so long as you attribute Justice Connect as author and retain this and other copyright notices. You may not modify this resource. Apart from any use permitted under the *Copyright Act 1968* (Cth), all other rights are reserved.

To request permission from Justice Connect to use this material, contact Justice Connect at PO Box 16013, Collins Street West, Melbourne 8007, or email nfplaw@justiceconnect.org.au.