paulramsay FOUNDATION

sfl Centre for Social Finance Law

THE QUICK GUIDE TO

Australian Legal Vehicles for Purpose-Driven Business and Investment

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Foreword

Australia's social entrepreneurs and impact investors play a critical role in addressing societal and environmental issues and driving positive change. However, navigating the legal landscape can be daunting, particularly for newcomers and those with limited resources.

Setting up and funding a purpose-driven business is made more complex by the way purpose and profit are separated under Australian law. There is no legal entity designed to combine them. From a legal point of view purpose and profit are at best fellow travellers and more often strange bedfellows.

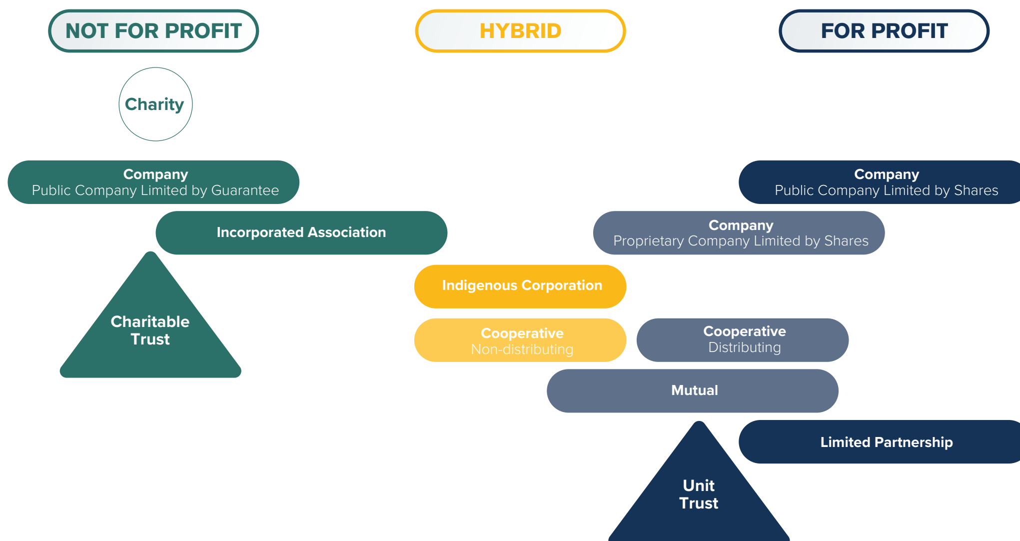
This makes legal structuring a critical early consideration. But it can be hard for those setting up and running a purpose-driven business, and for their financial supporters – whether investors or grant makers – to find out what their options are.

The Centre for Social Finance Law and the Paul Ramsay Foundation have prepared this introductory short guide to legal structures in Australia to fill that gap. We believe that reliable information on legal structures is important for fostering innovation and sustainability within the sector.

The for-purpose sector is diverse, comprising organisations with varying missions, sizes, and operational models. This guide offers a starting point for understanding the options – the legal "building blocks" – and for considering the potential impact of the legal structure.

Understanding the rights and obligations, the opportunities and constraints, and the compliance requirements of the legal "building blocks" is critical to having a legal structure that is a platform for growth and not a quagmire of problems. Ensuring compliance with the structure's legal requirements is essential for transparency, accountability and public trust, as well as maintaining tax treatment, licensing, registration and other benefits.

The information contained within this document should be considered as general background in the broader decision-making process of all those undertaking or supporting purpose-driven business.[1]



1 This Guide is issued subject to the Important Notice at the back of this Guide.

Company

At a glance:

- A *public company limited by guarantee* is mission-friendly, debt investor only, ASIC regulated with statutory reporting and limited liability.[2]
- A *public or proprietary company limited by shares* is mission-capable, investor-friendly, ASIC regulated with statutory reporting and limited liability.

Legal Features

Australian companies are governed by the *Corporations Act 2001* (Cth) and regulated by **ASIC** (Australian Securities and Investments Commission) – the company registrar (**asic.gov.au**).

There are three main types:

- A proprietary company limited by shares (i.e. a private company) (**Pty Co**);
- A public company limited by shares (**Public Co**); and
- A public company limited by guarantee (**CLG**).

A *company limited by guarantee* is designed as a not-for-profit. It cannot issue shares or pay dividends but it can borrow. Its constitution usually regulates the distribution of any surplus on a winding up.

Both categories of a *company limited by shares* are intended to be for-profit vehicles. They are open to both equity and debt investors. They can be structured as mission led, for-purpose-for-profit vehicles – some social enterprises are Pty Cos structured this way.

A *Pty Co* cannot have more than 50 non-employee shareholders.

All three types of company have limited liability – for CLGs each member's liability is limited to the amount of the member's guarantee, and for Public and Pty Cos, the amount unpaid on the member's shares.

Regulation and Reporting

Upon registration with ASIC a company is issued with an **ACN** (Australian Company Number).

All public companies must prepare a *financial report* and *directors' report* every financial year – with financial reports needing to be independently audited or, where applicable, reviewed.

A proprietary (private) company generally only needs to prepare these reports if it is 'large' (two of: revenue $50m+; assets $25m+; employees 100+) or directed to do so by ASIC or its members.

A company must submit its first set of financial statements within 4 months after the end of its first financial year (or 3 months if it is listed or, broadly, has 100+ members). A company's *first financial year* starts on its registration date and ends 12 months later, or up to 18 months later if the directors so determine.

A company (like other businesses) will also need an **ABN** (Australian Business Number) and **TFN** (Tax File Number) for tax administration.

A *Pty Co* cannot offer its shares to retail investors (or in any way that requires regulated investor disclosure) except to existing shareholders, employees or by way of regulated crowd-sourced funding.

2 *Limited liability* refers to the principle that the liability of a member (ie an investor) to creditors of the legal entity is limited to the amount (if any) unpaid on the member's shares or the amount the member has undertaken to contribute to the company's property if the company is wound up.

Mission and Social Enterprise

At a glance:

- There is currently no company structure in Australia that is specifically designed for mission-focussed enterprises like the *Community Interest Corporation* (CIC) in the UK or the *Benefit Corporation* in the USA.
- A social enterprise in Australia can adopt a variety of legal forms – and there are also some relevant certifications available.
- A social enterprise may or may not be a charity – these are separately regulated (see **page 8**).

Mission

Generally a charitable trust is the most effective legal structure for embedding mission in Australia, but it is a not-for-profit.

It is possible to embed mission in a for-profit Pty Co through constitutional provisions in a way that is adequate for most practical purposes – see the *For Purpose & Profit Constitution* and commentary at **sflcentre.com/library** for a more detailed discussion.

Social Enterprise

A social enterprise is a business for good that (using the *Social Enterprises Australia* approach - **socialenterpriseaustralia.org.au**) exists to create impact through trade by doing three things:

- Having a defined primary social, cultural or environmental purpose consistent with a public or community benefit;
- Deriving a substantial portion of its income from trade; and
- Investing efforts and resources into its purpose, such that public/community benefit outweighs private benefit.

Certification

B Corp certification (**bcorporation.com.au**) and *Social Traders* accreditation (**socialtraders.com.au**) are available and are designed to create identifiable ethical/social businesses based on the firm's practices and – for Social Traders – investment of efforts and resources into its purpose.

Legal Structure

A social enterprise can adopt a variety of legal forms. It is commonly a Pty Co or an incorporated association (sometimes with embedded mission – see above) but it can be structured as the trading arm of a charitable entity, or as a Co-op or Indigenous Corporation, or as another legal structure tailored to meet the three characteristics noted on this page.

Similarly B Corp certification is in principle available to any form of legal structure that is a trading entity and meets the B Corp criteria. In practice the corporate and Co-op structures are generally better able to do so than other legal structures noted in this Guide.

Limited Partnership

At a glance:

- A *limited partnership* (LP) is generally mission-capable and investment-capable with limited regulation and statutory reporting.
- An *LP structured for venture* capital is investor-friendly, IIC regulated with some statutory reporting but with regulatory limits to mission.
- LPs provide *limited liability* for *limited partners* but general partners have unlimited liability.

Legal Features

A limited partnership (**LP**) is formed when it is registered under State or Territory partnership legislation (e.g. *Partnership Act 1892* [NSW]).

An LP may have any number of *limited partners* (who are effectively passive investors) but must not have more than 20 general partners.

An LP is not a separate legal entity but it can become so by being registered as an incorporated limited partnership under relevant State or Territory legislation (known as an **ILP**).

ILPs are commonly used for venture capital funds in Australia.

To obtain the concessional tax treatment available for eligible venture capital funds, the limited partnership must register under the *Venture Capital Act 2002* (Cth) (i.e. as well as under the relevant partnerships legislation). It is administered by Industry Innovation and Science Australia – Innovation Investment Committee (**IIC**), a statutory board established by the Federal Government.

Regulation and Reporting

An LP is regulated by the State or Territory agency that administers the partnership legislation (e.g. in NSW, the Department of Fair Trading).

The limited partnership does not receive an ACN but it does receive an identifying registration number from the relevant State or Territory agency upon registration.

That State or Territory agency maintains a register of limited partnerships registered in its jurisdiction.

The partnership's name is registered with ASIC as a business name.

There is no general statutory reporting obligation. There are usually reporting obligations under the Partnership Deed. There may be reporting obligations to satisfy tax status or other accreditations.

Cooperatives and Mutuals

At a glance:

- A *Co-op/Mutual* provides goods and services to its members (who may be consumers, employees, enterprises or a hybrid mix) on an equitable basis.
- Within that focus, Co-ops and Mutuals are generally mission-friendly, investment-capable and regulated with statutory reporting and limited liability.

COOPERATIVES

Legal Features

A Cooperative (**Co-op**) can be either 'distributing' or 'non distributing':

- A *non-distributing co-operative* is prohibited from giving returns or distributions on surplus or share capital to members, other than the nominal value of shares (if any) at winding up.
- A *distributing co-operative* may distribute to members a part of the surplus generated in a year but only by way of a rebate, bonus shares or a limited dividend. The maximum amount of the limited dividend is prescribed by the *Cooperatives National Regulations*. In NSW, the dividend is limited to 10% more than the interest on a $100,000 5 year term deposit.

One of the *7 co-operative principles* (which guide all Co-ops) is that members may allocate surpluses for any or all of the following purposes:

- Developing the Co-op, possibly by setting up reserves;
- Benefiting members in proportion to their transactions with the Co-op;
- Supporting other activities approved by the membership.

Those distribution restrictions do not apply to *Cooperative Capital Units* (see below).

Co-ops operate on a *one member* one vote basis regardless of the amount invested. The right to vote attaches to membership and not shareholding. To retain membership a member must be an "*active member*".

The "business judgement" rule for directors of Co-ops is different to companies as they are expressly allowed to take into account the *7 co-operative principles*.

Regulation and Reporting

Cooperatives are regulated by State and Territory agencies under a Cooperatives National Law that has been adopted in each State and Territory. In NSW that agency is the Department of Fair Trading (**fairtrading.nsw.gov.au**). They do not have an ACN.

A large co-operative is required to prepare an *annual financial report* and *directors report*. A small co-operative (broadly, a Co-op which has not: (a) issued shares above the 20 prospective members/$2M annual threshold or issued securities to non-members, and (b) meets any two of the less than $8M revenue, $4M assets and 30 employees thresholds) is not required to do so unless directed to do so by the members or the Registrar.

Generally, a Co-op is required to report to members and lodge its reports with the Registrar within 5 months after the end of the financial year.

- If it is a "disclosing entity" (eg, 100 or more debenture holders), it must also provide half-yearly reports to the Registrar.
- The same rules apply to the first annual reports after registration but (as for companies) the first financial year of a co-operative may extend from the date of its registration to a date not more than 18 months after its registration.

Investing in a Co-op

Co-ops can borrow from commercial lenders, members and the public. There are no legal restrictions on the terms and conditions of the loan arrangements a Co-op may make with commercial lenders. As a borrower in this market, Co-ops are no different from any other entity.

Cooperative Capital Units (CCU) are a security available to Co-ops. A CCU is broadly an interest in the capital (but not the share capital) of the Co-op.

- CCUs can be held by non-members. They don't give any voting or other rights as a member but CCU holders do have voting rights at meetings of CCU holders.
- All Co-ops can offer CCUs to non-members or members and employees provided the Co-op's constitution permits the issue of these instruments. Non-distributing Co-ops will need to seek advice about structuring CCUs so that the distribution rights of CCUs do not breach their non-distribution rules. The terms of issue must be approved by the Registrar.
- CCUs were introduced because, while all Co-ops can issue shares, generally they can only issue shares to members. CCUs are treated as a form of financial accommodation like debentures.

Investing in a Co-op: Distribution on winding up

On a *winding-up,* Co-ops do not have an 'Asset Lock' restricting the distribution of assets:

- CCUs have priority in a winding up according to their terms of issue.
- For members and shareholders, generally a co-op may be wound up in the same way and circumstances as a company.

However, a non-distributing co-operative is prohibited from giving returns or distributions on surplus or share capital to members, other than the nominal value of shares (if any) at winding up.

MUTUALS

Legal Features

A **Mutual** is a *company* registered under the *Corporations Act 2001* (Cth) which provides in its constitution that a person has no more than one vote at a general meeting of the company for each capacity in which the person is a member of the company (i.e. the same *one member one vote* principle as applies to Co-ops).

Mutuals have a similar investment instrument to a CCU called a Mutual Capital Instrument (**MCI)**. A mutual that is a registered charity cannot issue MCIs.

Mutuals are prevalent in the finance industry (e.g. credit unions, building societies and friendly societies) and are often grouped with trading co-ops when discussing the cooperative (or CME) sector.

Regulation and Reporting

As companies registered under the *Corporations Act 2001* (Cth), mutuals are subject to the same registration, reporting and other regulatory requirements as apply to their type of company under that Act (as outlined above).

Many mutuals were originally financial services Co-ops and mutuals that transferred to company registration in the early 2000's and their constitutions generally set out additional governance and membership matters comparable to the membership and governance features of Co-ops registered under the Co-operatives National Law.

Indigenous Corporation

At a glance:

- An *Indigenous Corporation* is a company designed for the needs and circumstances of Aboriginal and Torres Strait Islander people.
- It is mission-friendly, investor-restricted and ORIC regulated with statutory reporting and limited liability.

Legal Features

An Indigenous Corporation (**IC**) is formed by registration under the *Corporations* (*Aboriginal and Torres Strait Islander*) *Act 2006* (**CATSI Act**).

To be *eligible* for registration it must have:

- At least 5 members, a majority Aboriginal or Torres Strait Islander (**ATSI**) persons over 15 years old (includes corporations controlled by ATSI persons);
- At least a majority of directors being ATSI persons over 18 years old who are members, ordinarily resident in Australia and not employees; and
- A constitution that complies with the CATSI Act.

Capital raising is restricted. The CATSI Act does not provide for the issue by an IC of shares, debentures or other securities. However, an IC can raise funds through loans from members or financial institutions.

This limits *distributions* of assets on a winding up. An IC can include rules in its rule book relating to the distribution of profits to members and (subject to its constitution) after paying all liabilities, can distribute surplus assets to members on a winding up.

Other *Indigenous business accreditations* include:

- Certification by Supply Nation (50%+ Indigenous-owned, based in Australia).
- Recognition for Australian Government's *Indigenous Procurement Policy* (50%+ Indigenous-owned).

Regulation and Reporting

The regulator is the Office of the Registrar of Indigenous Corporations (**ORIC** or the **Registrar**) (oric.gov.au).

An IC receives an Indigenous Company Number (**ICN**) upon registration. It reports to ORIC (not ASIC) and, if it is a registered charity, it also reports to the ACNC.

The form and content of *IC reports* is specific to the CATSI Act:

- Small ICs with consolidated gross operating income ("CGOI") less than $100,000 – general report only (detailed overview of business performance and factors underlying results/financial position);
- Small ICs with CGOI between $100,000 and $5 million – general report plus financial report and audit report (or financial report based on reports to government funders); and
- Large ICs or any IC with a CGOI of $5 million or more - general report, financial report, audit report and directors report.

The reports are required to be *lodged* with the Registrar within 6 months after the end of the financial year.

In the case of the first reports, an IC's *first financial year* ends on the next 30 June after registration (or the second 30 June if it is registered between 1 January and 30 June in any year).

Charity

At a glance:

- A *charity* is a not-for-profit registered as a charity by the ACNC, thereby eligible for tax concessions – it may be a company, trust or other legal structure.
- It is mission-friendly and is capable of being a social enterprise with power to borrow but it is designed for donors, not investors.

Legal Features

A charity is defined by its *charitable purpose* rather than its legal form. Generally any type of legal entity can be registered by the ACNC as a charity other than an individual, political party or government entity. The most common forms are an incorporated association, a charitable trust or a CLG.

A charity can invest and engage in revenue raising activities, provided doing so is in pursuit of its charitable purposes.

To be eligible for ACNC registration the entity must be *not-for-profit* (**NFP**), with objects that are only charitable purposes – as listed in the *Charities Act 2013* (Cth) – for the *public benefit*, and must meet *ACNC governance standards*.

The NFP requirement includes an absolute (100%) restriction in its constitution on income distributions to members and an 'asset lock' which restricts the distribution of surplus on a winding up – generally to another not-for-profit.

NB: Even if the charity is structured as a Pty Co (which has happened but is rare) there is no economic value in its shares due to the NFP restrictions. If the NFP restrictions are removed, the charity will lose its registration and thereby, its tax concessions.

Regulation

The **ACNC** (Australian Charities and Not-for-profits Commission) is the national regulator of charities (acnc.gov.au).

A charity must have an **ABN** (Australian Business Number). The Registrar of the Australian Business Register (ABR) is the Commissioner of Taxation.

ASIC reporting (along with certain other provisions) is "turned off" under Part 1.6 of the Corporations Act for companies registered as charities by the ACNC.

Charitable fundraising is regulated by State and Territory charitable fundraising legislation.

Capital Raising

The charity's constitution may empower it to borrow, enabling it to raise debt capital, but the NFP restrictions on income and capital distributions *(see Legal Features*) mean that, regardless of its legal form, a charity cannot raise equity capital.

Tax Concessions

Registered charities qualify for various income and other charity tax concessions.

A sub-group of registered charities – those which are public benevolent institutions (**PBI**) or fit within other eligible categories – can apply to the Australian Taxation Office (**ATO)** (ato.gov.au) to be endorsed as a deductible gift recipient (**DGR**).

- Endorsement can apply to the whole organisation or to a gift fund it operates.
- DGRs enjoy additional charity tax concessions. In particular a donor to a DGR can deduct the amount of their gift from their taxable income in their income tax return.

Reporting

All charities are obliged to submit an *annual information* statement to the ACNC. Medium and large charities are also obliged to submit an *annual financial report* to the ACNC. Broadly:

- Small charities - Annual revenue under $250,000.
- Medium charities - Annual revenue $250,000 to $1 million.
- Large charities - Annual revenue of $1 million or more.

The reports must be submitted within 6 months after the end of each of the charity's reporting period (usually a financial year but can be a calendar year).

Where a charity is registered within 3 months of the end of its first reporting period, it can choose to make its first report at the end of the next period (i.e. up to 15 months).

PAFs and PuAFs

A *Private Ancillary Fund* (**PAF**) is a type of charitable trust which provides individuals, families or associations with an investment structure for philanthropic purposes.

Gifts (which are tax deductible for PAFs endorsed by the ATO as DGRs) are made by associated parties to the PAF and managed by the PAF trustee. PAFs are registered and regulated by ACNC, must be endorsed by the ATO to receive charity and DGR tax concessions, must be not-for-profit with rules restricting the distribution of surpluses outside its charitable purposes (including on a winding up or revocation of endorsement) and must solely benefit other "tier 1" DGRs (i.e. PBIs and other relevant categories of DGR).

A *Public Ancillary Fund* (**PuAF**) is similar to a PAF but designed for public contributions and participation in the administration of the fund (in contrast to a PAF where there is a close relationship between those who establish the fund, those who donate to it and those that operate the fund).

A PAF must philanthropically distribute 5% of the market value of its assets or $11,000 (whichever is greater) each financial year. The minimum annual philanthropic distribution rate for a PuAF is 4% or $8,800.

PAF and PuAF Regulation

PAFs and PuAFs are regulated by the ACNC as registered charities.

They must comply with the ATO's *Private Ancillary Fund Guidelines 2019* and *Public Ancillary Fund Guidelines 2022.*

To be eligible for endorsement by the ATO, a PAF or PuAF must (in addition to the features noted elsewhere in this section):

- Be a fund established and maintained in Australia under a will or instrument of trust;
- Hold an ABN;
- Have the power to invest money in ways that Australian law allows trustees to invest trust money; and
- Have a corporate trustee or trustees (or for a PuAF, the Public Trustee or another prescribed trustee).

Trust

At a glance:

- A *Unit Trust* is mission-capable, investor-friendly, usually with limited liability and generally unregulated except for tax and if it is registrable as an MIS.
- A *Charitable Trust* is mission-friendly, business-capable but ACNC regulated and restricted to debt investors and charitable fundraising.
- The *trustee* is likely to be separately ASIC regulated as a company (with limited liability) and may require AFSL or other licensing.

Legal Features

A trust is generally established by a trust deed or will to prescribe how a cash fund or other assets (*trust property*) must be held and managed by the nominal owner (*trustee*) for the benefit of the people (*beneficiaries*) or purpose (*charitable objects* or *purpose*) that the person setting up the trust (*settlor* or *founder*) wishes to help.

Trusts are flexible and can generally be structured to meet purpose-driven objectives. Typical forms of trust include:

- *Unit Trusts* – Often used for investment purposes, may attract ASIC regulation, the trust deed usually limits unitholder liability;[3]
- *Charitable Trusts* – Generally regulated by the ACNC as registered charities and relevant State and Territory agencies when undertaking charitable fundraising; and
- *Discretionary Trusts* – Common for family enterprises, generally unregulated.

The trustee is separate from the trust and is commonly a company, subject to ASIC and other corporate regulation.

In some circumstances a trust may have a tax treatment that is beneficial for particular types of investment.

Regulation and Reporting

There is no registrar or regulator for trusts, as such. However:

- If the trustee is a company, ASIC will regulate that company;
- If the trust is a registered charity, ACNC will regulate it as a charity.

The trust may also attract regulation on another basis, e.g:

- By ASIC, if it is registrable as a managed investment scheme (**MIS**) under the Corporations Act;
- By ATO, to meet the tax requirements for the trust to obtain its intended tax treatment; and
- By ASIC or other regulators, if the trustee requires an AFSL (Australian Financial Services Licence) or other licensing to perform its duties as trustee.

Trusts do not receive an ACN. A corporate trustee will have its own ACN. A registered scheme (i.e. a registered MIS) has an **ARSN**.

The Corporations Act financial reporting requirements do not directly apply to trusts but they will apply to a corporate trustee and also to a registered scheme (and for a scheme the deadline for lodging with ASIC is 3 months after the end of the financial year).

3 Unit trusts are often structured so that unitholders have similar rights and obligations to shareholders in a company but there are some legal differences.

Incorporated Association

At a glance:

- An *incorporated association* is intended for small-scale, non-profit and non-commercial activities largely within one State or Territory.
- Within that framework it is mission-friendly, locally regulated with statutory reporting and limited liability, but it is not appropriate for investors.

Legal Features

An incorporated association is a separate legal entity incorporated under the *Associations Incorporation Act* of a State or Territory.

It is designed for small-scale, non-profit and non-commercial activities, providing protection for members in legal transactions. It is commonly used for charities, trade associations, and social and recreational clubs. Organisations operating as commercial enterprises are not eligible for incorporation under the Act.

It can operate outside its State of incorporation but is unlikely to be an appropriate vehicle if the majority of its operations are outside its home State.

Regulation and Reporting

An incorporated association is registered and regulated by the State or Territory agency that administers the associations legislation (e.g. in NSW, the Department of Fair Trading). It does not have an ACN but its name (which must include “Incorporated” or “Inc”) is registered and able to be searched in ASIC and relevant State or Territory registers.

Incorporated associations have annual reporting obligations. The annual financial statements of a Tier 1 association (gross annual receipts above $250,000 or current assets above $500,000) must be audited.

Changing Structure

Changing company type

It is possible under the Corporations Act to:

- Change a proprietary company to a public company limited by shares and vice versa.
- Change a public company limited by guarantee (**CLG**) to either a public company limited by shares or a proprietary company, but not from a company limited by shares to a CLG.

A change of type does not create a new legal entity or affect the company's existing property, rights or obligations.

Switching associations

There are some statutory procedures for converting from one type of association to another (e.g. an incorporated association to a CLG, Co-op or IC).

Outside those special procedures, a switch from one type of legal vehicle to another would generally require the creation of the new vehicle and the transfer of assets and liabilities to that new vehicle.

IMPORTANT NOTICE

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