

30 September 2019

Our ref: WD-NFP

Australian Accounting Standards Board (AASB)
PO Box 204
Collins St West VIC 8007

By email: standard@asb.gov.au

Dear Standards Review Team

AASB Exposure Draft 291 - Not-for-Profit Entity Definition and Guidance

Thank you for the opportunity to provide comments on the Exposure Draft 291: Not-for-Profit Entity Definition and Guidance (Exposure Draft). The Queensland Law Society (QLS) appreciates the opportunity to comment on this important issue.

QLS is the peak professional body for the State's legal practitioners. We represent and promote over 13,000 legal professionals, increase community understanding of the law, help protect the rights of individuals and advise the community about the many benefits solicitors can provide. QLS also assists the public by advising government on improvements to laws affecting Queenslanders and working to improve their access to the law.

This response has been compiled by the QLS Not-for-Profit Law Committee whose members have substantial expertise in this area.

The Exposure Draft proposes a definition of "*an entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.*"

With respect to the Exposure Draft we raise the following:

- We are concerned that the proposed definition does not achieve an appropriate outcome because:
 - It may unintentionally limit the scope of the definition, as not all not-for-profit entities will provide goods or services; and
 - The concept of "equity" does not fit well with all not-for-profit entities given the wide variety of structures that feature in this sector.
- The "non-distribution constraint" concept is a more appropriate founding concept for any revised definition of a not-for-profit entity.

Andrew Lind (the chair of the QLS Not-for-Profit Law Committee) has recently submitted an article titled "*THE NON-DISTRIBUTION CONSTRAINT AND SOCIAL ENTERPRISE - CAN*

SHARE CAPITAL FUND NONPROFIT ORGANISATIONS?” (unpublished), for peer review publication in an academic journal. That article deals at some length with the legal meaning of not-for-profit in Australia and we quote from it with his permission below.

“The current Australian legal meaning of not-for-profit is determined by its ordinary meaning and the common law.

In short the common law meaning of not-for-profit is *not-for-private-profit* (Dal Pont 2000, p. 22). The making of profit from trade by a NFP (for example by schools and hospitals) is permissible as long as the profit is applied to the NFP purposes (*Brighton College v Marriot* [1926] AC 192, *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55) as opposed to private persons (*Incorporated Council of Law Reporting (Queensland) v Federal Commissioner of Taxation* (1971) 125 CLR 659). The private persons excluded from the profits need not be *members* but in practice anyone other than another similar purpose NFP or the ultimate beneficiaries of the NFP purpose (Garton 2013, para. 6.05; Chesterman 1979, p. 179 in a UK context with the same approach being applied in Australia).

It is accepted at common law that an entity may still be not-for-profit even though private persons are:

- paid reasonable remuneration for goods supplied or services rendered to a NFP (*Hester v Commissioner of Inland Revenue* [2005] 2 NZLR 473, *Brighton College v Marriot*);
- benefit in a subsidiary or incidental way as a result of the carrying out of the main public NFP purpose (for example *Cooperative Bulk Handling Ltd v Commissions of Taxation* [2010] FCA 508, para. 121, where the benefits to ‘growers’ were categorized in this way); or
- benefit as the ultimate beneficiaries of the main public purpose for example patients at a hospital, students at a school (*Motor Industry Training Association of Western Australia (Inc) v City of Joondalup* [2013] WASAT 14), or those in poverty being fed or housed (*Joseph Rowntree Memorial Trust Housing Association Ltd v Attorney-General* [1983] 1 Ch 159 at 176).

The *Explanatory Memorandum* to the (then) Australian Charities and Not-for-profits Commission Bill 2012 (Cth), sets out the meaning of not-for-profit as follows (which is effectively a restatement of the common law):

3.33 A NFP entity is generally an entity that is not operating for the profit or gain of its individual members, whether these gains are direct or indirect. This applies both while the entity is operating and when the entity winds up.

3.34 Additionally, an NFP entity is one that does not provide any private benefit, directly or indirectly, to a related party such as a trustee, member, director, employee, agent or officer of a trustee, donor, founder, or to an associate of any of these entities (other than reasonable remuneration for services provided or re-imbusement of related costs).

3.35 However, the fact that a NFP entity may make a profit does not negate its NFP status so long as any surplus is applied to the NFP purposes of the entity

and the profit does not accrue to the benefit of identifiable members either directly or indirectly. (p.32)

The Australian Taxation Office (**ATO**) in its published guidance and in TR 97/22: *Income tax: exempt sporting clubs*, administratively adopts the common law meaning of not-for-profit. The current ATO published guidance on the meaning of not-for-profit follows:

“An organisation is non-profit if it is not carried on for the profit or gain of its individual members. This applies for direct and indirect gains, both while the organisation is being carried on and on its winding up. We accept an organisation as non-profit if its constitution or governing documents prohibit distribution of profits or gains to individual members and its actions are consistent with the prohibition. (Definition Non-profit n.d. emphasis added)”

“Is your organisation an NFP? ...

We will accept your organisation as an NFP if these governing documents prevent you from distributing profits or assets for the benefit of specific people - both while it operates and when it winds up. ...

Example

The following example would be acceptable to us.

Non-for-profit clause

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

Dissolution clause

‘In the event of the organisation being dissolved, the amount that remains after such dissolution and the satisfaction of all debts and liabilities shall be transferred to another organisation with similar purposes which is not carried on for the profit or gain of its individual members.’ (Is your organisation a NFP n.d.)”¹

The Supreme Court of South Australia, in *The Lutheran Laypeople's League of Australia Inc* [2016] SASC 106, effectively adopted the guidance published by the ACNC and the ATO saying, ‘There is no definition of not-for-profit in the ACNC Act but, ... some assistance can be gleaned from information published by the [Australian Charities and Not for Profits] Commission and the Australian Tax Office.’ (Hinton J., para. 49)

¹ <https://www.ato.gov.au/Non-profit/Getting-started/What-type-of-NFP-is-your-organisation-/#IsyourorganisationanNFP> - accessed 24 September 2019

At the heart of the current ACNC and the ATO regulatory guidance, is the *non-distribution constraint*.

The term 'non[-]distribution constraint' was first mentioned in the academic literature as the touchstone of what makes an entity a not-for-profit by Henry Hansmann in 1980 in the following passage:

What Makes an Organization Nonprofit?

A nonprofit organization is, in essence, an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees. By "net earnings" I mean here pure profits - that is, earnings in excess of the amount needed to pay for services rendered to the organization; in general, a nonprofit is free to pay reasonable compensation to any person for labor [sic] or capital that he provides Since a good deal of the discussion that follows will focus upon this prohibition on the distribution of profits, it will be helpful to have a term for it; I shall call it the nondistribution constraint. (Hansmann 1980, p. 838)

A proposed statutory definition of 'not-for-profit' (never enacted) was proposed for the *Income Tax Assessment Act 1997 (Cth)* at the time of the introduction of the *Charities Bill 2013 (Cth)* (Explanatory Memorandum 2013, para. 1.22) in item 44 of the *Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (Cth)* as follows:

not-for-profit entity means an entity that:

(a) is not carried on for the profit or gain of its owners or members, neither while it is operating nor upon winding up; and

(b) under an Australian law, foreign law, or the entity's governing rules, is prohibited from distributing, and does not distribute, its profits or assets to its owners or members (whether in money, property or other benefits), neither while it is operating nor upon winding up, unless the distribution:

(i) is made to another not-for-profit entity with a similar purpose; or

(ii) is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.

The ACNC in its submission to the 2018 *Review of the operation of the Australian Charities and Not-for-profits Commission Act 2012 (Cth) and the Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012 (Cth)* submitted that a statutory definition of not-for-profit would be desirable but:

would require careful consideration. In particular, the definition should make clear that the provision of incidental private benefits to members of an organisation or to charitable beneficiaries does not preclude the organisation from being 'not-for-profit' or charitable under the general law or the Charities Act. (ACNC, Submission to the Review n.d., p. 24)

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The ACNC legislation Review Panel did not recommend a statutory definition of not-for-profit 'at this time' but rather that the legal meaning should develop through the common law."

All of this suggests that seeking to arrive at a brief definition of not-for-profit even for the purposes of the Accounting Standards should of course be undertaken with significant caution.

QLS submits that the "non-distribution constraint" and the common law provides a sound foundation for a revised definition.

QLS suggests that perhaps instead of:

an entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

a draft along the following lines could be considered, bearing in mind its application to charitable trusts and that the legal meaning is currently shifting with the common law:

an entity regraded as a not-for-profit for the purposes of the Income Tax Assessment Act 1997 (Cth)

Note: The legal meaning of not-for-profit is currently given by the common law. For example this would include an entity whose governing rules have the effect of obliging the application of the assets and income of the entity to further its purposes (both during operation and on winding-up), and prohibiting the payment or provision of private benefit except for reasonable compensation or payment for services or goods, or relation to capital a return of the capital (as opposed to a share in the entity value) and a reasonable cost of that capital.

Such a definition would link the meaning to the meaning for the purposes of Commonwealth taxation laws and the regulatory guidance proposed by the ATO from time to time.

If you have any queries regarding the contents of this letter, please do not hesitate to contact our Legal Policy team via policy@qls.com.au or by phone on (07) 3842 5930.

Yours faithfully



Bill Potts
President

Encl: Reference List

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