

The Purpose of your Incorporated Society - Can it make money? And who can take it home?

“One of the interesting clarifications under the proposed Incorporated Societies Bill relates to money making activities undertaken by societies and member's access to monies or assets of the incorporated society.”

Sadly there have been some past examples of bad behaviour in this area. The frustrating aspect of this is that the behaviour has often been technically "legal", but at the same time completely unethical. Examples have included members joining asset rich incorporated societies, often with low or declining member numbers, with a view to strip funds and other assets out for their personal benefit. Techniques have included paying over market remuneration, bonuses, asset transfers at well below market value, and attempts to liquidate the society and distributing funds to remaining members.

Thankfully we see this area explicitly addressed in the proposed Bill.

Guiding Principles of the proposed Bill

The following are the fundamental principles that were identified by the [Law Commission](#) in their work and now incorporated into the proposed Incorporated Societies Bill:

- Societies are private bodies operated by their own members
- Societies should not distribute profits or financial benefits to members
- Societies should be free from inappropriate Government interference

This is a level of explicit clarification that did not exist in the 1908 Act. It is also useful when considering the wide variety of incorporated societies in existence at present in NZ and pondering whether all of these should be incorporated societies or whether another legal form may in fact be more appropriate.

Financial Gain

The financial gain provisions of the Bill are contained in sub-part 2, clauses 21 and 22. These clarify that a society cannot have a primary purpose of being carried on for financial gain of its members. As such any distribution or ability to make a distribution to members is expressly prohibited. The Bill also clarifies that this includes distributions in kind as well as money.

On initial reading this may cause some societies to worry that their trading and other income generating activities may put them under threat. This is not the case though as the Bill goes on to explicitly clarify:

However, a society (or proposed society) does not have a purpose of financial gain, and is not being carried on for the financial gain of any of its members, merely because it will or may:

- engage in trade;
- pay a not-for-profit member for matters that are incidental to the purposes of the society;
- reimburse a member for reasonable expenses legitimately incurred on behalf of the society or while pursuing the society's purposes;
- provide benefits to members of the public or of a class of the public and those persons include members of the society or their families;
- pay a member a salary or wages or other payments for services on arm's length terms;
- enter into any other transaction with a member on arm's length terms;

- provide a member with incidental benefits (for example, trophies, prizes, or discounts on products or services) in accordance with the purposes of the society.
- This clarifies that it is allowable for a society to trade and to actively seek to generate income for the purposes of its cause or purpose. However with the clear proviso that individual members cannot personally stand to gain from this. Helpfully key terms such as "**arm's length**" are also defined:

In subsection (3) (e) and (f), salary, wages, or other payments for services, and other transactions, are on arm's length terms if

- the terms:
 - would be reasonable in the circumstances if the parties were connected or related only by the transaction in question, each acting independently, and each acting in its own best interests; or
 - are less favourable to the member than the terms referred to in subparagraph (i);
- and the salary, wages, or other payment for services, or other transaction, does not include any profit share, percentage of revenue, or other reward in connection with the activities of the society.

This last point will be interesting as some existing incorporated societies, especially those with large trading operations and of scale do currently pay some of their senior employees bonuses related to financial performance and meeting or exceeding budgets. On initial reading this practice would now appear to be under threat.

To provide further control and give legal "**teeth**" the Bill also allows the court to take action to recover a financial gain from a member, and to liquidate a society if it carries on any operation that is contrary to the financial gain provisions.

It also explicitly prohibits a society's constitution from conferring on any member any right, title or interest in the property of a society.

As regards liquidation, clause 161(2), states that any surplus assets of a society that is liquidated or deregistered must be given to one or more other not-for-profit entities. The term "**not-for-profit entity**" is also defined to reduce the scope for cute wriggling around that one.

Summary

The considerably more explicit dealing with financial gain should considerably improve the sector by helping to reduce scope for legal but unethical bad behaviour.



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