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Proposed New Incorporated Societies Act
Commercial, Consumers & Communications Branch
Ministry of Business, Innovation & Employment
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30 June 2016

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Submissions on the Proposed New Incorporated Societies Act

We refer to the exposure draft of the *Incorporated Societies Bill* (“**the Bill**”), which was released for public consultation on 10 November 2015. We appreciate the opportunity to comment and do so below.

1. General

- 1.1 We support the replacement of the Incorporated Societies Act 1908 (“**the Act**”) and welcome the Ministry of Business, Innovation & Employment’s (“**MBIE’s**”) acknowledgement that the Act fails to cover important matters that affect the operation of societies.
- 1.2 We acknowledge and support MBIE’s main purpose in drafting the Bill, which is to remove uncertainty.
- 1.3 Overall, we agree with the vast majority of the measures in the Bill, which support creating a new Incorporated Societies Act to benefit all incorporated societies operating in New Zealand. However, we would like to bring a few matters to your attention that we ask you to consider.

2. Main submission aspects

- 2.1 As outlined in more detail in paragraphs 3 to 10 below, our main submissions include:
 - 2.1.1. We support the reduction in the minimum number of members of societies but submit that this should be further reduced to five members.
 - 2.1.2. We recommend consultation between MBIE and the Commissioner of Inland Revenue (“**the Commissioner**”) regarding the Bill’s provisions describing “financial gain” (clause 22 of the Bill) and “not-for-profit entity” (clause 24(4) of the Bill) with a view to aligning the intention and scope of such concepts between New Zealand’s incorporated societies and the revenue legislation.
 - 2.1.3. We submit that it should not be mandatory for societies to have constitutions. Instead they should be given flexibility to have the provisions of the Bill to apply to their affairs automatically in a similar manner as applies in the context of the Companies Act 1993. Alternatively, the Bill should provide for a model constitution that societies could adopt in whole or in a modified form, depending on their circumstances.

- 2.1.4. We further submit that the Bill should clearly state that societies may have different classes of memberships.
- 2.1.5. We welcome the provision set out in clause 25(1)(b) of the Bill which allows a society to express its tikanga or culture. However we submit that this provision should be qualified by a requirement that the society's tikanga or culture must not, in the opinion of the Registrar, be illegal or offensive.
- 2.1.6. We submit that clause 58 of the Bill should adopt a stricter approach, namely that conflicted officers must not take part in deliberations and must not be counted for the purposes of a quorum.
- 2.1.7. We submit that clause 172(1)(d) of the Bill should be amended to require societies to submit full legal names of their past and present officers.
- 2.1.8. We submit that it is important for societies to bring the fact of limited liability of their members to the attention of third parties and that the Bill should be amended to include a provision to this effect.

3. Minimum membership requirements

- 3.1 In Clause 8 of the Bill the minimum membership requirement for incorporation of a society is proposed to be reduced from 15 to 10. Further, the Bill requires a minimum ongoing membership of 10 (please see clause 66(1)). We submit that the minimum initial and ongoing membership requirement should be further reduced to 5. In the New Zealand Law Commission NZLC R 129, *A New Act for Incorporated Societies*, June 2013 ("**the Law Commission Report**"), the Law Commission noted that this was the most common preference of the submitters who wanted a change in minimum membership numbers.¹ This would align the Bill with the current requirement for minimum membership of societies incorporated under the Charitable Trusts Act 1957.² Further, as the Law Commission noted, a number of Australian statutes require fewer members than 10. For instance, Victoria and New South Wales allow the incorporation of associations with only 5 members.³
- 3.2 Societies should be allowed to start their life with a small membership which could then grow once the society becomes established or, indeed, a society should be allowed to operate having just 5 members. Imposing a higher minimum membership threshold in combination with the requirement for a constitution (further discussed below) may make societies impractical to incorporate, losing their appeal.

4. Definitions of financial gain and not-for-profit entity

- 4.1 We acknowledge and support the Bill's treatment of the division of surplus assets to other not-for-profit entities on removal or liquidation of a society found in clauses 161 to 165 and welcome the attempts to describe in some detail the sorts of circumstances which may indicate purposes of financial gain, when members will or will not be regarded as able to obtain financial gains (clause 22 of the Bill) and to define "not-for-profit entity" (clause 24(4) of the Bill). Nevertheless, we are

¹ The Law Commission Report at [4.13].

² Charitable Trusts Act 1957, s 8(3).

³ Associations Incorporation Reform Act 2012 (Vic), section 3; Associations Incorporation Act 2009 (NSW), s 6; as noted in the Law Commission Report at [4.9].

concerned that there may be confusion and uncertainty when seeking to apply various provisions in the revenue legislation such as those providing income exemptions or tax credits for donations.

- 4.2 We are not aware of any discussions which MBIE may have had with the Commissioner on such matters. We recommend that there should be some, or further, consultation between MBIE and the Commissioner with a view to aligning the intention and scope of such concepts between the incorporated societies and revenue law and revising the Bill and/or the relevant revenue legislation to achieve that end.
- 4.3 A single example of the issues that may arise if the Bill is enacted as currently drafted arises in the context of the proposed definition of a not-for-profit entity in clause 24(4) of the Bill. This is similar to the definition of an approved donee organisation found in section LD 3(2)(a) of the Income Tax Act 2007. However, there are slight differences between the wording of clause 24(4) of the Bill and section LD 3(2)(a) of the Income Tax Act 2007 which may lead to confusion and uncertainty:
- 4.3.1. Section LD 3(2)(a) provides that a donee organisation is: “a society, institution, association, organisation, or trust that is not carried on for the private pecuniary *profit* of an individual, and whose funds are applied *wholly or mainly* to *charitable*, benevolent, philanthropic, or cultural purposes within New Zealand [emphasis added]”.
- 4.3.2. Clause 24(4)(c) of the Bill, in contrast, provides that a not-for profit entity, in addition to a society incorporated under the Bill and a charitable entity within the meaning of the Charities Act 2005, is: “a society, institution, association, organisation or trust that is not carried on for the private *benefit* of an individual, and whose funds are applied *entirely or mainly* for benevolent, philanthropic, cultural or public purposes in New Zealand [emphasis added]”.
- 4.4 The relatively minor difference in wording from “wholly or mainly” (in section LD 3(2)(a) of the Income Tax Act 2007) to “entirely or mainly” (clause 24(4) of the Bill) creates unnecessary inconsistency and uncertainty between the two provisions.
- 4.5 Section LD 3(2)(a) is currently the topic of an issues paper⁴ as the Commissioner recognises that the definition of a donee organisation raises uncertainty and confusion over what constitutes “wholly or mainly” and that there may be some inconsistency in practice. The draft views expressed in the issues paper appear to represent a significant change of approach on the Commissioner’s part to the meaning of those words and as to how they might be applied in practice. Therefore, the use of a slightly different phrase of “entirely or mainly” in the Bill is likely to increase confusion and uncertainty for societies.
- 4.6 The terminology used in the Bill may well provide a better reflection of the intended concepts and scope, which could usefully be incorporated into the revenue legislation. We do not have any final views on that. As noted above, we are concerned to ensure that the various government bodies involved with these different areas of New Zealand’s law are consulting with each other with a view to achieving some coherence and consistency.

⁴ Inland Revenue Public Rulings Unit, Issues Paper No. 9), *Donee Organisations – clarifying when funds are applied wholly or mainly to specified purposes within New Zealand (IRPRUIP9)*.

5. Mandatory constitutions

- 5.1 Clause 23 of the Bill states that every society must have a constitution. As bodies corporate with a separate legal personality, incorporated societies are similar in nature to companies. In New Zealand a private company can be incorporated with or without a constitution.⁵ If a company chooses to incorporate without a constitution, its internal procedures are automatically governed by the Companies Act 1993.⁶
- 5.2 We submit that the same flexibility should be legislated for in the Bill. Costs associated with drafting constitutions can sometimes be significant and not all groups of potential members of new societies can afford the expense. Likewise, many existing incorporated societies, whose constitutions will need to be amended as a result of the changes proposed in the Bill, should be given the flexibility to disapply their current constitutions and agree to have the provisions of the Bill (as enacted) govern the societies' internal procedures by default. Societies without constitutions should be given flexibility under the Bill to adopt bylaws which would deal with matters not covered by the Bill and in which they could express their tikanga or culture.
- 5.3 We note that the Law Commission considered this issue but concluded that it is preferable for societies to have constitutions that can be easily and regularly referred to as opposed to having rules located in statute.⁷ Nevertheless, in an effort to reduce the burden and streamline the incorporation process the Law Commission recommended that the Bill provides for a model constitution in regulations that a society could adopt by "ticking a box" on its application for incorporation.⁸ This recommendation has not been adopted in the Bill (which instead provides for adoption of certain "standard provisions"). We submit that the Bill, as currently drafted, should be revisited and the real impact on existing societies needing to amend their current constitutions be ascertained together with the likely cost to those seeking to incorporate new societies.
- 5.4 Having no flexibility to adopt a model constitution or to have the provisions of the Bill automatically apply to a society will mean that societies and members will often have no other option but to seek assistance from the legal profession when drafting or amending their constitutions. This might create issues for smaller societies who do not have the same financial resources as other societies.

6. Classes of membership

- 6.1 Under clause 24(1)(c) of the Bill, the constitution must contain rules regarding how a person becomes a member and subpart 5 of the Bill contains other clauses relating to members. It is common for incorporated societies to have different classes of members⁹ but this is not reflected anywhere within the aforementioned clauses. We submit that it would be beneficial if the Bill recognised this by stating that a society may have different classes of members, putting this matter beyond doubt, in the same way as the Companies Act 1993 clearly states that companies may have different classes of shares/shareholders.¹⁰

⁵ Companies Act 1993, s 26 (it being noted that a public listed company is required to adopt a constitution in accordance with the NZX Listing Rules).

⁶ Companies Act 1993, s 28.

⁷ The Law Commission Report at [7.4] – [7.6].

⁸ The Law Commission Report at [7.7]; [7.41] – [7.64].

⁹ This common fact has been reflected in the Law Commission's Report, at [4.19], [8.7], [8.29] and [8.31].

¹⁰ For instance Companies Act 1993, ss 12(1)(d)(ii), 37, 48, 53, 83, 87, 95, 112, 116, 148 and 189.

7. Tikanga or culture

7.1 Clause 25(1)(b) of the Bill provides that the constitution may provide for the society to express its tikanga or culture. This is a welcome provision unique to New Zealand. We submit that this provision should be qualified by a requirement that the society's tikanga or culture must not, in the opinion of the Registrar, be illegal or offensive (aligning it with the limitations placed on proposed name of society set out in clause 10 of the Bill).

8. Conflicts of Interest

8.1 Under clause 58 of the Bill, an officer who is interested in a matter relating to a society must not vote or take part in any decision of the committee relating to the matter and must not sign any document relating to the entry into a transaction or the initiation of the matter. However, the clause allows the conflicted officer to take part in any discussion of the committee relating to the matter and be present at the time of the decision of the committee. The conflicted officer may also be counted for the purposes of determining whether there is a quorum at any meeting at which the matter is considered.

8.2 We submit that clause 58 of the Bill should adopt a stricter approach, namely that interested officers must not take part in deliberations and must not be counted for the purposes of a quorum. There could be a risk that the presence of a conflicted officer at deliberations may influence the outcome of the deliberations and thus in our view this should be prohibited.

8.3 We note that clause 58 of the Bill gives the committee a discretion to decide that the conflicted officer be excluded from any discussions of the committee relating to the matter and not be present at the time of the decision of the committee. Any such decision would have to be made on the basis of a policy adopted by the society. It is difficult to get societies to draft a sound conflicts of interest policy and apply it consistently. The flexibility currently afforded by clause 58 will appeal to many and the stricter approach we propose might not always be practical. However, on balance, we believe the stricter approach will provide more clarity and will minimise the potential of disputes arising.

8.4 It follows in our submission that officers who are conflicted and not allowed to be present during deliberations ought not to be counted towards a quorum.

8.5 Indeed our approach outlined in paragraphs 8.2 – 8.4 above is the approach currently taken by the charities regulator, Department of Internal Affairs – Charities Services.¹¹

9. Contents of register

9.1 Clause 172(1)(d) of the Bill states that the register of incorporated societies must contain the names of the officers of each society and of all persons who have been officers of the society since the society was first registered as a society. While we support the need for this basic requirement, we submit that this provision should be amended to require societies to submit *full legal names* of their past and present officers. This will remove the inconsistencies apparent in the register of companies which allows directors' names to be recorded in various different ways based on the combination of their initials, forenames and surnames.

¹¹ Please see: <https://www.charities.govt.nz/im-a-registered-charity/officer-information/officer-kit/conflict-of-interest/>

10. Mandatory use of name

10.1 The Law Commission recommended the Bill include a “mandatory use of name” provision equivalent to section 25 of the Companies Act 1993, requiring an incorporated society to clearly state its name in every written communication or document creating legal obligations.¹² This provision does not appear in the Bill. The “mandatory use of name” provision in the Companies Act 1993, together with the requirement to add the words “Limited” to the company’s name, acts as a warning to third parties that the shareholders’ liability is limited.¹³ We submit that it is likewise important for societies to bring the fact of limited liability of their members to the attention of third parties.

Please contact Silvia McPherson (silvia.mcpherson@nz.ey.com / 021 927 383) if you would like to discuss any aspect of our submissions.

Yours sincerely
EY Law Limited
Withheld

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Partner

¹² The Law Commission Report at [7.72] – [7.74].

¹³ The Law Commission Report at [7.72].