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Background and context

Within the context of a declining tax base, and declining social and environmental outcomes driving increased government spending, impact investment provides an important 'tool-kit' to deliver improved social and environmental outcomes. Governments must lead and intervene in the case of market failure; and as community degradation ensues and public welfare and general spending increases under what is increasingly being recognised as one of the failures of globalisation and market deregulation policies of recent decades, impact investment as a tool-kit can leverage the power of the market-based economy to facilitate solutions to some of these seemingly intractable challenges.

In the context of Impact Investment as Innovation - to focus tech innovation while overlooking social innovation fails to unify the conversation and is possibly the greatest missed opportunity to 'catch a wave' we've seen in public policy in recent years given the sectors' combined capacity for positive large scale disruption.

The critical role of the Australian Government

Federal government public spending of circa \$350 billion per annum includes many billions on Band-Aid solutions to problems that require systemic changes to address their underlying causes. The role of governments in enabling a social impact/benefit corporation business structure is as critical to Australian innovation as its support for innovation more broadly.

Further, the absence of support for social impact/public benefit corporations constrains social innovation and increases the public cost of delivering social outcomes.

The *2017 Social Impact Investing Discussion Paper* provides a framework for governments to now collectively act to remedy this.

We encourage the Federal Government to catch up to the US, UK and Canada in the impact investment market. By leveraging trillions of dollars globally in private equity the impact investment market is potentially more innovative and impactful than the rest of the innovation and ideas boom combined. It speaks to an increasingly conscious consumer sentiment. And finally, and significantly, it has government spending upsides, including a far less myopic spend and an increased ability to leverage private equity.

About Impact Seed

Impact Seed is part of the rapidly emerging Impact Investment ecosystem which aims to solve society's greatest social and environmental challenges through power of the markets.

We are capacity builders focused on growing impact investment in conversation with impact businesses, government, CSR and private wealth, and demonstrating why the 'business for good' model works in bridging investment and philanthropy.

We're passionate about social innovation, creating sustainable social impact and creating a working space for Social Businesses to be identified, supported and to thrive. We want to



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build the pool of investment, and the number of investments in Social Businesses that can provide market-rate return to investors and social impact at once.

Our services include:

- *CoCre8*: A community innovation initiative that engages local communities in identifying and coalescing around specific social challenges, and ideating innovative solutions
- *Enterprise Matching*: Incorporating an NFP residency engagement framework within which Impact Seed aims to identify alternative revenue streams within community services sector organisations, and match them to aligned social enterprises to develop financial sustainability and improved social outcomes.
- *Impact Spark*: an accelerator program delivering customised modules supporting specific business and impact needs;
- *Advocacy, Profiling and Education*: Development and delivery of pitch events and learning events, bringing together potential investors, and investable projects and organisations;
- *Impact Starter*: a social start-up funding platform, based on community-matched funding campaigns which leverage and de-risk partner contributions.

Impact Seed's Submission

Our submission makes some minor points towards a number of the consultation questions, and these are listed below. However, the major thrust of our submission is related to 5.4 of the Discussion Paper with regard to Legal Structures.

1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?

- a. The capacity and willingness of governments and organisations at all levels to share data and information. Impact investing cannot work unless we have a clear and common understanding of the social issues, and a clear and common plan about how to measure progress over time.
- b. Governments in Australia have been more reticent, and perhaps risk-averse, to entering this space than in other jurisdictions. Government engagement, especially for social impact bonds or pay for performance contracts, is critical.
- c. There is some appetite from potential investors to try impact investing at a small scale; however the number of projects or initiatives with the capacity to take on investment, especially large investment, is relatively small. Investment is required to build capacity in the eco-system in order to provide this capacity-building support in turn to the projects and initiatives that need it.

4. What do you see as the role of the Australian Government in developing the social impact investing market?

- a. A co-funder with state and potentially local governments
- b. Removing potential barriers to impact investment (for example, consider changing the Corporations Act to give certainty for Directors to include social impact in their decision-making).
- c. Providing incentives to leverage this kind of investment (for example, tax incentives for impact investors).

9. What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?

There are clearly a number of infrastructural and jurisdictional challenges with regard to the implementation of the public data policy. However, one that we are choosing to focus on with this submission is related to culture.

It is widely acknowledged that government = bureaucracy. There is a necessary societal reason for this. However, even if all structural and systemic barriers were removed around the sharing and dissemination of data and information, there would still be a cultural issue at play.

We believe that the structural barriers can be identified and reformed in a relatively acceptable period of time. However, the cultural inertia among the public service to sharing information and data will take much longer to overcome.

5.4 Legal Structures for Social Enterprise

Note: This element of our submission has been adapted from a paper written for a course on NFP Law at UWA. The question originally posed for the paper was with regard to the 'blurring' between traditional not-for-profit and for-profit boundaries, and whether, in a legal sense, the idea of the 'not-for-profit' element of charity was still useful and relevant. In the course of my research it became clear that the NFP element is still very important. Arguments for alternate legal structures often focus on the need of social enterprises – the fact that new legal structures are required because they just don't fit those that are currently available. However it became clear to me in researching this paper that that is not the only argument to be made. Alternate legal structures are also important to maintain the integrity of our charitable legal structures. Therefore, there is a dual interest for the government with considering alternate legal structures – a) protecting charitable legal structures AND b) providing a vehicle and a flag to accelerate impact investment

Introduction

The traditional dichotomy between for-profit and not-for-profit (NFP) has been blurred over time, the NFP condition is, and can continue to remain, relevant to the definition of charity and to charity registration with the Australian Charities and Not-for-profits Commission (ACNC). The essential element offered by the NFP condition is a 'flag' to the public that the



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entity is locked from distributing profit to members and this is critical to the public trust and confidence of the charitable/NFP sector.¹ However, it is clear that the trends that have blurred the lines between for-profit and NFP must be accommodated in our system. Otherwise the risk is that the concept of charity, and its NFP condition, becomes less relevant.

The system needs reform, drawing on experiences of other jurisdictions, to ensure that the concepts of charity and NFP remain focussed and relevant into the future.

Unlike traditional business structures, social impact/benefit corporations are at once a powerful government policy signal, and consumer-facing mechanism for driving and signaling focus on these areas. Over the past 10 years many of Australia's key trading partners have realised this and passed enabling legislation for these social impact/benefit companies to incorporate or re-incorporate (for example Kickstarter, or Patagonia in the US).

Sometimes a simple act of zero-cost policy change can create a positive seismic shift in entire industries. Creating a legal structure for social impact/benefit corporations is a free win for policymakers as it costs the budget nothing, while being both a small step and a giant leap towards generating a world-class social impact and impact investment market.

How has the traditional dichotomy been blurred?

Deloitte has identified through its Millennial survey that of the next generation of leaders, 87% believe that the success of a business should be measured in terms of more than just its financial performance.² The corporate sector has evolved over time, moving from corporate social responsibility, to social license to operate, and now to 'shared value'. 'Shared value' is generated by a strategy that has both an identifiable economic benefit to the company and a measurable impact on a social or environmental issue.³ Shared value leverages the business experience of the corporate partner, and the NFP partners' experience in working with communities. For example, GSK, a pharmaceutical firm has partnered with Save the Children, in a way that goes 'well beyond the traditional charity corporate fundraising model.'⁴ GSK and Save the Children work together to prevent children in developing countries dying from preventable diseases. They are 'combining [GSK's] capabilities in R&D, supply chain, procurement and vaccines with Save the Children's expertise working with the most vulnerable children.'⁵ The Australian government has

¹ Charity and NFP do not always refer to the same thing, though they are overlapping concepts. This essay uses the most specific term appropriate for any given context (ie if it is possible to say charity instead of NFP, this will be done).

² Deloitte, 'The Deloitte Millennial Survey 2016, (2016) available at <http://www2.deloitte.com/global/en/pages/about-deloitte/articles/gx-millennials-shifting-business-purpose.html#report>

³ Shared Value Project and SVA, 'The State of Shared Value in Australia', 2015, accessible at <http://sharedvalue.org.au/wp-content/uploads/2016/01/2015-State-of-Shared-Value-in-Australia-Report-Double-Spread.pdf>, 11, accessed 8 October 2016

⁴ GSK, 'Save the Children Partnership' (n.d.) accessible at <http://www.gsk.com/en-gb/about-us/corporate-partnerships/save-the-children-partnership/#overview>, accessed 8 October 2016

⁵ Ibid.

recently expressed its intention to work in this way to amplify the impact of Australia's aid investments.⁶

From the NFP sector perspective, social enterprise, though still a contested term, is on the rise. Most agree it is the concept of entities trading to fulfil their social purpose.⁷ They may be profit-distributing or they may be a not-for-profit entity, but that is not what defines them – it is the trade, when traditionally, trade was the domain of the corporate sector.

Impact investment is another emerging trend. Investors give up some proportion of financial return in an investment, in return for some measurable social good generated (or 'social return')⁸, even though traditionally the purpose of investments is to maximise profit. Impact Investing Australia provide some evidence as to the quantum of this trend in their 2016 report, finding that 'more than two thirds of all investors expect impact investing to become a more significant part of the investment landscape in the coming years; [and] active investors would ideally triple the size of their impact portfolios over the next five years.'⁹

Finally, in the US, UK and Canada there has been the development of a number of new legal structures, regulated by the state, which are neither clearly for-profit nor not-for-profit. All of these trends are challenging notions of what is for-profit, what is not-for-profit and/or charitable and how social impact sits with all of this.

The 'NFP condition'

The NFP condition is a requirement of being a charity for the purposes of tax exemption, and to be registered with the ACNC. The legal definition of not-for-profit requires that the organisation is not 'carried on for the profit or gain of its individual members'. This requirement is usually demonstrated through the constitution of the organisation having a 'not-for-profit' clause which states that no profits or assets of the organisation are distributed to members; and when the organisation winds up that its assets will be provided to another organisation with similar provisions in its constitution. Importantly, this does not mean an organisation cannot make profit, just that it must not be distributed to members. This reinforces the purpose of charity law in that government, donors and the public can be certain that funds provided to or generated by a NFP will not be distributed in the form of dividends. The charity is constitutionally 'locked out' from distributing its profits anywhere but towards its purpose and objects. This in turn should bolster public, and donor, trust and confidence.

Arguments for the relevance/utility of NFP condition

⁶ Australian Government, n.d. 'Creating shared value through partnership: Ministerial statement on engaging the private sector in aid and development', access at <http://dfat.gov.au/about-us/publications/aid/Documents/creating-shared-value-through-partnership.pdf>, 1-2

⁷ Social Traders, 'About Social Enterprise' (n.d.) accessible at <http://www.socialtraders.com.au/about-social-enterprise/what-is-a-social-enterprise/social-enterprise-definition/>

⁸ Impact Investing Australia, 'About impact investing' (n.d.) accessible at <http://impactinvestingaustralia.com/resources/impact-investing-2/>

⁹ Krzysztof Dembek, Daniel Madhavan, Fabienne Michaux, Brad Potter, 'Impact Investing Australia 'Investor Report'' (2016) accessible at <http://impactinvestingaustralia.com/wp-content/uploads/Impact-Investing-Australia-2016-Investor-Report.pdf>, accessed 15 October 2016

Trust and confidence

Maintenance of trust and confidence is the first, and key, reason why the NFP condition of charity is still useful and relevant. As previously described, the inability for a NFP to distribute profit means that the public and donors can be assured all funding is reinvested in the cause of the organisation.

The ACNC report on public trust and confidence in Australian charities demonstrates that the majority of respondents assumed charities were trustworthy.¹⁰ The drivers of trust are listed in three major groups – the charities' activities, the charities' reputation; and perceived wastefulness, which results in a negative impact on trust.¹¹ If people were asked directly how they felt about a charity that could make distributions to shareholders, it is likely that they would not feel that is a trustworthy organisation. This is an assumption based purely on some of the responses on perceived wastefulness. However, interestingly, the limitation on distribution for NFPs is not one of the immediate reasons that come to mind when considering why people trust charities. This may mean that if the charity is being effective and creating change, people may not care that they make some distribution to members.¹²

Is there a 'market'?

The second major reason why the NFP condition is relevant is seen in removing it and seeing what is left:

- Charitable purpose
 - o No disqualifying purpose/activities
- For the public benefit
 - o Actual benefit
 - o Public at large

Without the NFP condition:

- The organisation may pay dividends, or distribute profits to members;
- The organisation is not limited in ways of raising funds – it can take on equity investment;
- Upon wind-up it is not limited necessarily as to how it distributes its assets

The major benefit, then, is an ability to distribute profit to members. However, this requires equity investment, and investors will invest only if they think there is enough possibility for a financial return. Impact investors are willing to take slightly less financial return – however, they still want some financial return.

If a business, then, must have a charitable purpose and be for the public benefit, is it likely to be a business that can generate a substantial enough financial return in order to distribute profits to members? The answer to this is not straightforward – it would be highly dependent on the particular sector and context.

¹⁰ Australian Charities and Not-for-profits Commission, above n 27

¹¹ Ibid.

¹² But this can't be said definitively.

So, if the ability of charities to raise investment even if the NFP condition was removed is limited, (which it likely is) then the NFP condition actually maintains relevance and utility.

Arguments against the relevance/utility of NFP condition

The rise of social enterprise

Social entrepreneurs, people who are driven to make a *difference* in a particular area, find the decision on legal structure as one of the most important but confusing decisions they have to make.¹³ They are often forced into a structure which does not easily allow them to effectively balance the leveraging of market forces and social good. For those that choose a for-profit structure, distributing of profit is not necessarily the persuasive factor.¹⁴ Sometimes they will choose a for-profit structure in order to not have to report to a Board. Sometimes they will choose a NFP structure so they can access grants. It is not as though the ability to take profit out of the enterprise is the major reason for choosing that structure.¹⁵ The NFP condition, for them, has some utility but is by no means the deciding factor in their decision.

The market directly impacts well-being

An illustrative example lies in *Federal Commissioner of Taxation v Wentworth District Capital Ltd*,¹⁶ where a NFP formed to provide banking services to a rural town without commercial banks was held to be a 'community service organisation' eligible for tax exemption. This is a reminder of how the economy, traditionally considered in the 'for-profit' domain, is utilised for the well-being of people and communities.

Charities in regional and remote areas and especially in indigenous communities inevitably include some focus on economic development and/or employment participation.¹⁷ These cases demonstrate that the nature of business and commercial activities and well-being of people and communities is not as separate as has traditionally been thought, and is a further argument as to why the NFP condition of charity may not be particularly relevant.

Charitable purposes, activities, nexus

It is easy to see how the traditional dichotomy has been particularly broken down recently with regard to both what purposes are seen as charitable, and the permissibility of commercial activities of charities to meet their purposes. These trends are expanding the legal meaning of 'charity', and as Murray describes, demonstrates a general acceptance of 'more porous boundaries between charities on the one hand and government and commerce

¹³ Statement based on personal communication with approximately 25 different founders of NFP and FP social enterprise/business between June – October 2016: Bubdesk, Global Unmanned Systems, Community Insight Australia, Acavista, JB Were, Kirrikin, Brothaboy, Green Swing, 21st Century Dingo, Inspiratory, Startsomegood, Yoga for Pain, Gecko, Tech4Good, Armed for Life, The Henry Project, Flowerfox, the Care Collective, Work Life Calendar, and other founders with ideas who have not yet incorporated

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ (2011) 191 FCR 151

¹⁷ Ian Murray, 'The Taming of the Charitable Shrew: State roll back of charity tax concessions' (2016) 27 PLR 54, 67

on the other.¹⁸ This also provides cause to question how useful and relevant the NFP condition is to the concept of charity.

On the first topic – the expansion of purposes, *Chamber of Commerce and Industry of Western Australia Inc v Commissioner of State Revenue* [2012] WASAT 146 (CCIWA) demonstrates that an organisation can have, as its purpose, to generally support and advocate for business in WA, and this will be charitable. Further, that charity can provide specific assistance to individual businesses, along with more general assistance and still meet the public benefit requirement to be a charity.¹⁹ Further, as Murray describes, other purposes which seem to push the boundary have been accepted as charitable, ‘including the promotion of a culture of innovation and entrepreneurship in Australia and the promotion of the adoption of electronic commerce for Tasmanian businesses’.²⁰ These cases are not only an expansion of traditional charitable purposes, but are out of step with societal conceptions of charity, undermining trust and public confidence.

On the second topic – the acceptance of commercial activities to meet charitable purposes, *Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204²¹ (*Word Investments*) demonstrates that an organisation set up only to conduct a funeral business to generate income was charitable given it was ‘charitable in character because [the commercial activities] were carried out in furtherance of a charitable purpose’.²²

Kirby’s dissenting judgment in *Word Investments* focused more on Word’s activities than the majority which tended to just look at the charitable purpose only. Carrying on ‘investment and commercial funeral business activities for profit’ was not charitable in his opinion, and his Honour considered that the link between Word’s activities and the ultimate use of the funds generated was too remote.²³

Kirby’s judgment should be the preferred view. It seems at odds to spend significant time and effort crafting charitable purposes and fashioning the NFP condition if ultimately, the courts say that as long as the purpose is charitable, they do not need to look any further. If the purpose of an entity is all that matters, and all the Court should really look to, which is effectively the message from these cases, then the NFP condition shouldn’t be relevant either. This is not a purpose-oriented concept; it is a limit on the activities or mechanisms of an organisation in carrying out its purpose. In which case, by this reasoning, it should not be relevant.

Parliaments are concerned about this trend and in some states, as Murray describes, are legislating to prevent the expansion of both activities and purposes.²⁴ This suggests a desire

¹⁸ *Ibid.*, 60

¹⁹ *Ibid.*, 59

²⁰ *Bicycle Victoria Inc v Federal Commissioner of Taxation* [2011] AATA 444, [195]; *Tasmanian Electronic Commerce Centre Pty Ltd v Federal Commissioner of Taxation* (2005) 142 FCR 371; *Federal Commissioner of Taxation v Triton Foundation* (2005) 147 FCR 362; but found these cases due to their being cited in Ian Murray, above n36, 58

²¹ *Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204 (*Word Investments*)

²² *Ibid* [26]

²³ *Ibid* [180] (Kirby J)

²⁴ Ian Murray, above n 36, 64



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by governments to prevent the boundaries between commerce and charity being quite so porous. This suggests that it is important (at least to government) that these areas are not impermissibly widened, and that the NFP condition is relevant to them.

Distribution of profit is not the only way to move funds

Finally, one of the major arguments for the relevance and utility of the NFP condition of charity is that charities cannot remove money from the organisation to distribute to members. That is not to say that money cannot be removed from the charity in other ways. As Garton describes, 'the pursuit of profit is not the only way in which an organisation's mission can be distorted: high wages, extravagant facilities ... can unreasonably inflate administration costs and be as corrupting as the pursuit of profit.'²⁵ There is little data about the amount of CEO salaries in the Australian charitable sector²⁶, and it is important that the charitable sector is able to attract and retain talented people especially at high levels of management, so the argument is not that organisations should not pay high salaries. The argument is that even though a charity is limited from distributing profit, it can pay salaries and consulting fees, and the NFP condition is not able to prevent this from occurring.

²⁵ Jonathan Garton, above n 24

²⁶ This data depends on NFPs being open and transparent – World Vision is very good at this, posting on their FAQs on their website what the CEO earned in the last year. Costello received a salary of \$298,000 in 2015. Information accessible at <https://www.worldvision.com.au/about-us/faqs>



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Other jurisdictions

There are many lessons to learn from the US, UK and Canada, which have all changed their own systems to some extent to allow for this accommodation, with mixed success. The table below provides a snapshot of the new kinds of legal structures developed in other jurisdictions. The major lesson to take from this is that there is a place for a different legal structure within our own system.

	US Public Benefit Corporation	US L3C (low profit corporation)	Canadian CCC/CIC	UK CIC
<i>Where can this entity exist?</i>	30 US states	10 US states	BC & Nova Scotia	England, Wales, Scotland, Northern Ireland
<i>When was this concept enacted?</i>	2008	2008	2013	2006
<i>How many of these entities exist?</i>	3000	1200	30	2500
<i>Is there a prescriptive approach to balancing profit Vs benefit creation?</i>	NO	NO	YES	YES
<i>Must a public benefit report be posted?</i>	YES	NO	YES	YES
<i>Must the public benefit be audited?</i>	NO	-	NO	YES
<i>What are the broad prescriptive requirements of the benefit report?</i>	1) General public benefit 2) Specific benefit 3) Problems creating benefit 4) 3rd party standard	-	LIMITED	1) Stakeholder consults 2) Directors remuneration 3) Asset movements 4) Dividends
<i>Is the benefit report (or equivalent) audited/regulated?</i>	NO	-	NO	YES



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Must major shareholders and directors remuneration be disclosed?	NO	NO	NO	YES
Who are the primary regulatory bodies?	State legislatures	State legislatures	State legislatures	Community Interest Companies Regulator
Is it a for-profit entity?	YES	YES	YES	YES
Can it take on debt and equity investment?	YES	YES	YES	YES
Can it own shares in another company?	YES	YES	YES	YES
What kinds of charitable tax concessions can it obtain?	NONE	NONE	NONE	NONE

References for the above table:

<http://benefitcorp.net/sites/default/files/Benefit%20Corporations%20Chart.pdf>; <http://www.intersectorl3c.com/blog/104163/8364/>;
http://www.marcjlane.com/clientuploads/Articles/Marc-Lane-basic_l3c_primer.pdf; <https://www.quora.com/What-are-the-reporting-standards-for-bcorps-versus-L3cs>; https://ssir.org/articles/entry/benefit_corporation_and_l3c_adoption_a_survey; <http://www.fin.gov.bc.ca/prs/ccc/>;
<http://www.fin.gov.bc.ca/prs/ccc/caq.htm>; <http://www.bcregistryservices.gov.bc.ca/local/bcreg/documents/forms/form1c.pdf>; <http://b-lab.force.com/bcorp/PrintImpactAssessment?id=a03C000000OCns9IAD>; <https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>; <http://www.thirdsector.co.uk/analysis-rise-rise-community-interest-companies/governance/article/1348096>;
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/524218/13-786-community-interest-companies-frequently-asked-questions.pdf; https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211749/13-712-community-interest-companies-guidance-chapter-9-corporate-governance.pdf; <https://www.gov.uk/government/publications/form-cic36-application-to-form-a-community-interest-company>



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Conclusion and a proposal for the Australian system

Whilst the traditional dichotomy between for-profit and not-for-profit (NFP) has been blurred over time, the NFP condition is, and can continue to remain, relevant to the definition of charity and to charity registration with the ACNC. It is important for public trust and confidence, and if the only change made to the system was removing it, it would not make a substantial difference. Because the NFP condition is important, there should be a nexus between purposes and activities. This protects the concepts of NFP and charity and ensures that they do not lose all meaning.

However, action must be taken to create a better system to ensure these terms remain relevant and useful.

Innovation to better meet community need has led to social enterprise, impact investment, shared value, and many other trends. These are important for creating societal change. But currently, these elements are uncomfortably forcing their way into a system that does not accommodate them, and are diluting the terms that we have (including the importance of the NFP condition of charity). The system must have infrastructure that accommodates, fosters and supports these trends. For example, CCIWA does make a valuable contribution to society. ***But their description as a charity undermines public trust and confidence.***

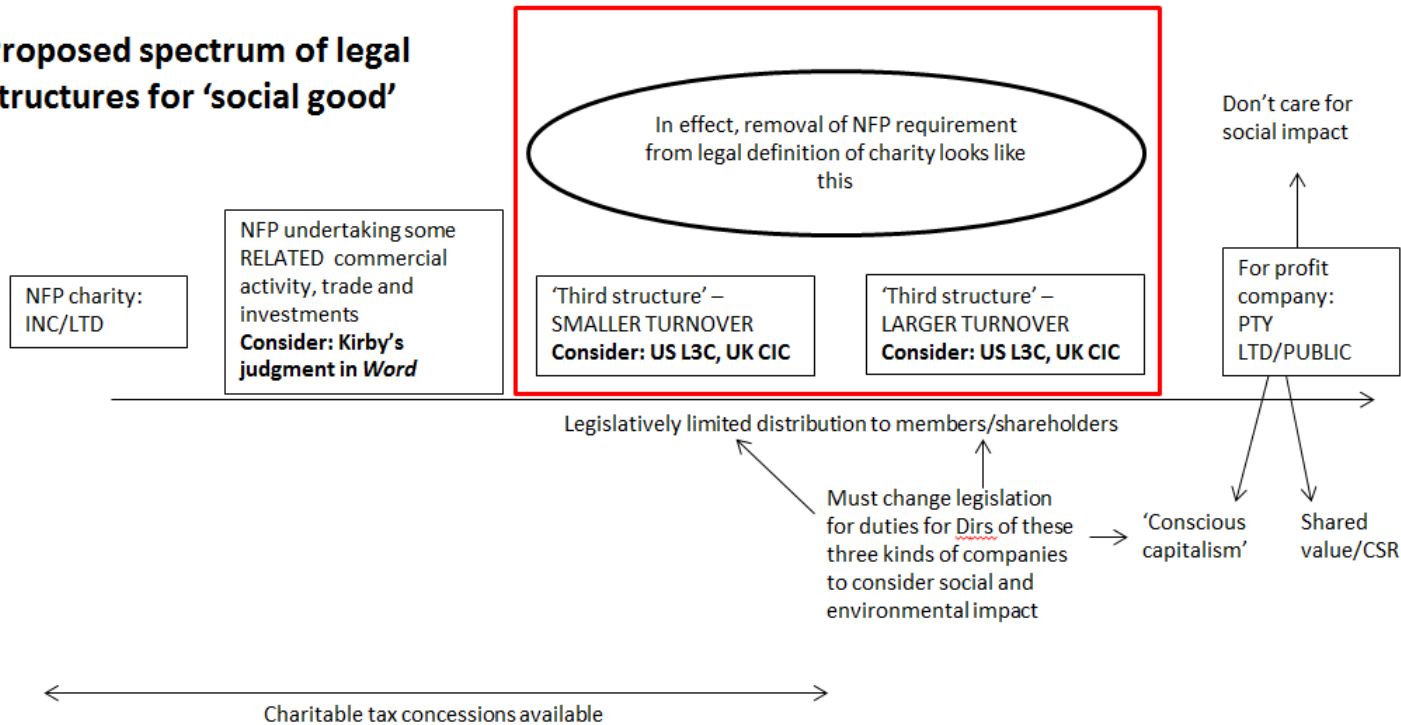
Overall, the evidence suggests that most NFP business income is generated by 'related' businesses. The Australian Council of Social Service (ACOSS) suggests that 87 per cent of businesses run by NFPs are an extension of services provided as part of their core mission.²⁷ This means legislating to ensure that we have more of Kirby's view in *Word Investments* in the law than the majority view, in practice, is not going to affect the vast majority of the sector.

The following page contains a diagram for a proposed spectrum of legal structures for 'social good' that would provide some of the accommodation necessary to protect the relevance and utility of concepts of NFP and charity²⁸, yet also encourage and support quality social impact for our communities, which is arguably the most important purpose of charity

²⁷ Australian Council of Social Service et al 'Giving Australia: Research on Philanthropy in Australia' (2005), accessible at <http://www.ourcommunity.com.au/files/GivingAustraliaSummary.pdf>, accessed on 15 October 2016, p43

²⁸ At least, in this author's opinion

Proposed spectrum of legal structures for 'social good'



Current state:





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