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3 August 2017

Senior Adviser
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: DGR@treasury.gov.au

Dear Sir/Madam,

Tax Deductible Gift Recipient Reform Opportunities

Please find attached Philanthropy Australia's submission in response to the Discussion Paper on tax deductible gift recipient reform opportunities.

Philanthropy Australia thanks the Treasury for the opportunity to make a submission in response to the Discussion Paper.

Philanthropy Australia would welcome the opportunity to discuss the matters raised in this submission further. In this regard, please do not hesitate to contact Krystian Seibert, Advocacy & Insight Manager, on (03) 9662 9299.

Yours Sincerely

Sarah Davies
Chief Executive Officer

Philanthropy Australia Submission – Tax Deductible Gift Recipient Reform Opportunities

1. About Philanthropy Australia

As the peak body, Philanthropy Australia's purpose is to serve the philanthropic community to achieve more and better philanthropy.

The community we serve consists of funders, grant-makers, social investors and social change agents working to achieve positive social, cultural and environmental change by leveraging their financial assets and influence.

Informed, independent and with reach and credibility, Philanthropy Australia gives its Members a collective voice and ability to influence and shape the future of the sector and advance philanthropy.

We also serve the community to achieve more and better philanthropy through advocacy and leadership; networks and collaboration; professional learning and resources; and, information and data-sharing.

Our membership consists of approximately 800 trusts, foundations, organisations, families, individual donors, professional advisers, intermediaries and not-for-profit organisations.

Philanthropy Australia shares the Australian Government's desire to grow philanthropy and values our ongoing dialogue with the Government regarding ways to achieve this.

We therefore strongly support initiatives such as the Prime Minister's Community Business Partnership, and also appreciate the opportunity to constructively participate in this consultation process.

2. Comprehensive Reform of the DGR Framework is Needed

The taxation framework for philanthropy is critical to supporting a vibrant and growing culture of giving in Australia.

Philanthropy Australia believes that this taxation framework should be based around principles of simplicity, clarity, certainty and ensuring there are appropriate incentives to encourage philanthropy.

Philanthropy Australia's submission in response to the Discussion Paper is informed by these principles.

The Deductible Gift Recipient (DGR) framework set out in Division 30 of the *Income Tax Assessment Act 1997* (Cth) underpins philanthropy in Australia. It provides an important incentive for philanthropy by allowing donations to DGRs above $2 to be tax deductible. Access to DGR status is therefore essential to access a large proportion of philanthropy, and philanthropic structures such as private and public ancillary funds can only make distributions to so called 'Item 1' DGRs.

Division 30 has evolved in an ad hoc manner, resulting in a DGR framework that is complex, cumbersome and a source of red tape. The lack of comprehensive reform of our DGR framework continues to impede the ability of many charities to access philanthropy.

Australia has just under 55,000 charities. Based on 2016 data, there are approximately 28,500 entities with DGR status. Not all of these are charities, but the overwhelmingly majority are.

The practical result of this is that private and public ancillary funds are unable to make distributions to just under half of Australia's charities, as they can only make distributions to DGRs. Conversely, these charities are denied the opportunity to seek support from a large and growing segment of the philanthropic sector, nor accept tax deductible donations from the broader community. This is not a satisfactory situation.

The rather arbitrary approach to determining eligibility for DGR status under Division 30 is evident in the types of charities which 'fall between the cracks' and whose only option is to seek a 'specific listing' in the tax law – a long and complicated process, requiring a legislative amendment and with only a remote possibility of success.

For example, an institution whose principal activity is to promote the prevention or the control of *diseases* in human beings is eligible for DGR status under the category of a 'Health Promotion Charity'. However, because of the way disease is defined, an institution whose principal activity is to promote the prevention of *injuries* of human beings (such as through accidents) is not eligible for DGR status.

Philanthropy Australia therefore believes that comprehensive reform of the DGR framework is needed as recommended by the Not-for-profit Sector Tax Concession Working Group's report *Fairer, Simpler and More Effective Tax Concessions for the Not‑for‑Profit Sector* (May 2013), which built upon a similar recommendation in the Productivity Commission's report *Contribution of the Not-for-Profit Sector* (February 2010).

This would involve extending DGR status to all charities that are registered with the Australian Charities and Not-for-profits Commission (ACNC), but use of tax deductible donations would be restricted to purposes and activities that are not solely for the advancement of religion, or the advancement of education through child care and primary and secondary education, except where the activity is sufficiently related to advancing another charitable purpose.

Such a change would move Australia closer to the situation in jurisdictions such as the United States, Canada and the United Kingdom.

The Working Group's recommendation was estimated to cost $120 million per year in forgone revenue.

Whilst we understand that such reform is not on the Australian Government's agenda at this time, Philanthropy Australia believes that in the absence of such comprehensive reform, the DGR framework will continue to not be fit for purpose, notwithstanding some positive incremental improvements which can be made and which are canvassed in this Discussion Paper.

The following sections address the reforms proposed in the Discussion Paper, as well as some reforms which are not addressed in the Discussion Paper but which Philanthropy Australia believes need to be included in any package of incremental DGR framework reform.

3. Main Comments on the Discussion Paper

Although mostly incremental, Philanthropy Australia believes that several reforms proposed in the Discussion Paper are positive and we would welcome their implementation.

This includes introducing a new requirement for a DGR (other than a government entity) to be a registered charity in order for it to be eligible for DGR status, transferring the

administration of the four DGR Registers to the ACNC and the Australian Taxation Office (ATO), and removing the public fund requirements for DGRs.

However, we have major concerns about new reporting requirements for charities undertaking advocacy, and limitations being placed on the ability of environmental charities to undertake advocacy.

In addition, we believe that any package of reforms to the DGR framework must address:

- The ongoing uncertainty associated with the Australian Government's proposal to re-introduce an 'In Australia' requirement for DGRs
- The barriers to the growth of community foundations and collective/collaborative giving arising from the current DGR framework.

Advocacy by Charities

Philanthropy Australia is very concerned by proposals in the Discussion Paper that relate to advocacy activities by charities.

These include a proposal for new reporting obligations for advocacy activities (consultation questions 4-6), and a proposal to limit the level of advocacy undertaken by environmental organisations by requiring them to allocate 25%–50% of their donation revenue on environmental remediation (consultation question 12).

Australian charities can undertake advocacy to further their charitable purposes, for example through supporting or opposing relevant government policies and decisions. The importance and legitimacy of this was recognised by the High Court in the Aid/Watch decision of 2010,[1] where the Court held that charities undertaking advocacy was *essential* to Australia's constitutional system of parliamentary democracy. This decision was subsequently legislated in the *Charities Act 2013* (Cth).

Advocacy is an important approach that charities can use to address the causes of social and environmental problems, rather than just the symptoms – this often requires policy change.

For example, if a factory is polluting a river because of poor regulation, environmental remediation work to treat affected wildlife downstream will largely be futile and have little impact if the factory can continue to pollute the river. In order to preserve the river's ecosystem and stop the pollution, advocacy may be necessary to ensure the factory complies with regulations or that government introduces adequate regulations.

The effectiveness and efficiency of advocacy as an approach to achieving charitable purposes is a key reason that our Members may choose to fund advocacy activities by charities. It is also a very strong justification for why donations to support such activities by charities should be tax deductible – government should seek to encourage rather than discourage effective and efficient approaches to achieving charitable purposes.

The discussion paper asserts that 'some charities and DGRs undertake advocacy activity that may be out of step with the expectations of the broader community', however this assertion is made without any supporting evidence. Available public opinion polling shows very strong public support for the advocacy role of environmental charities in particular.[2]

For these reasons, the proposals in the Discussion Paper should not be proceeded with.

[1] See: http://www.austlii.edu.au/au/cases/cth/HCA/2010/42.html

[2] The Essential Report, 15 November 2016, p.9, available here: http://www.essentialvision.com.au/wp-content/uploads/2016/11/Essential-Report_161115.pdf

No justification has been put forward in the Discussion Paper regarding the need for new reporting obligations for advocacy activities.

If these obligations are similar to those contained in newly published reporting requirements for registered environmental organisations[3], they would require extensive record keeping by staff within charities in order to ascertain what proportion of their time is spent on advocacy activities. This would be unworkable in practice, and difficult if not impossible for the ACNC to verify in any event.

Therefore, any new reporting obligations for advocacy activities are strongly opposed on the basis that they would impose new and unjustified red tape on charities.

Requiring that a certain proportion of an environmental organisation's activities be directed towards environmental remediation represents an intrusion on the autonomy of environmental organisations and on philanthropy.

Charities and their supporters are in the best position to determine what approaches are most appropriate to achieve their charitable purpose within the boundaries of charity law – therefore, any new restrictions and limitations are strongly opposed on the basis that they would impose new and unjustified red tape on environmental charities and philanthropy.

Well-targeted and proportional approaches to maintain transparency and accountability for charities, including environmental DGRs, are supported. This can be achieved by requiring all DGRs to be registered as charities and hence be under the oversight of the ACNC, as the Discussion Paper proposes.

Existing charity law sets appropriate boundaries for what advocacy activities by charities are acceptable, for example, charities cannot have a purpose of promoting or opposing a political party or a candidate for political office.

The ACNC guidance for charities undertaking advocacy is helpful and reflective of the law. If further detail is necessary, the Commissioner of the ACNC could be asked to publish a 'Commissioner Interpretation Statement', which is a more detailed form of guidance that is binding on ACNC staff. It could provide case studies and seek to clarify when an activity becomes a disqualifying purpose under the *Charities Act 2013* (Cth).

Philanthropy Australia would support the preparation of such a Commissioner Interpretation Statement.

The 'In Australia' Requirement for DGRs

Australia's regulatory and taxation framework for international philanthropy imposes some of the highest barriers to international philanthropy in the world.

The Australian Government was previously intending to proceed with legislation (the 'In Australia' legislation) which would have codified a previous ATO view that DGRs must operate solely in Australia, and pursue their purposes solely in Australia (with some exceptions, such as overseas aid funds, some environmental organisations, some touring arts organisations and medical research institutes).[4]

In a welcome move, the former Assistant Treasurer (the Hon Josh Frydenberg MP) stated in 2015 that progressing this legislation is no longer a priority, however it still remains Australian Government policy. Given that this legislation is not being progressed at this stage, the ATO

[3] See the 'Register of Environmental Organisations 2017 statistical return form', available here: http://www.environment.gov.au/about-us/business/tax/register-environmental-organisations/forms

[4] See: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Conditions-for-tax-concession-entities

has adopted a view that charities established in Australia but which undertake their charitable activities overseas are now eligible for deductible gift recipient status. Public guidance on the ATO website has been altered to reflect this, and significant work has been undertaken to develop a draft public ruling to provide more detailed guidance on this matter.

For a hypothetical example, because of this change the 'Kalimantan Water Hygiene Foundation' can now be established as a 'Public Benevolent Institution' in Australia, and can raise funds for projects aimed at reducing the incidence of water borne diseases amongst disadvantaged communities in the Kalimantan provinces of Indonesia. It does not need to apply to become an 'overseas aid fund', which is a long and complex process administered by the Department of Foreign Affairs and Trade (DFAT).

Because of this change, an organisation has also been established as a 'Public Benevolent Institution' by a group of philanthropists in Australia, through which distributions from private ancillary funds are directed towards overseas projects. This has made it much easier for them to undertake their philanthropy, reducing the red tape that previously made the giving process more complex and costly.

For the same reasons as outlined above, the 'In Australia' requirement has previously made it very difficult for overseas charities to set up a fundraising arm in Australia.

For example, the hypothetical Kalimantan Water Hygiene Foundation could be set up in the United States to raise funds for projects aimed at reducing the incidence of water borne diseases in Indonesia.

However, if it wanted to set up an associated organisation in Australia in order to raise funds from Australians to support its activities in Indonesia, it previously would have needed to apply to DFAT to become an 'overseas aid fund'. Given how long and complex this process is, this has not been a realistic option for many organisations.

Because of the developments outlined above, the Kalimantan Water Hygiene Foundation can now set up a registered charity in Australia to raise funds from Australians to support its activities in Indonesia, without needing to apply to become an 'overseas aid fund'.

The change in the ATO's view regarding 'In Australia' has decreased red tape and improved the flexibility with which Australian philanthropy and charities can support charitable causes outside Australia. It is a positive development.

However, as stated above, it is still the Australian Government policy to introduce the so called 'In Australia' legislation, which if implemented would reverse these positive changes.

Given that this uncertainty regarding this legislation has continued for a number of years, Philanthropy Australia believes that the 'In Australia' legislation should be permanently set aside, to provide certainty and ensure that red tape is not reimposed on Australian philanthropists and charities wishing to make a difference beyond our borders.

Such a decision would be consistent with the Australian Government's stated objective to promote the role of private sector initiatives which support international development and complement Overseas Development Assistance.

It would also send a signal that the Australian Government supports the important contribution Australian philanthropy can make overseas through fostering positive relationships between Australia and countries within our region and beyond.

For these reasons, not progressing the 'In Australia' legislation would be strongly welcomed and supported by Philanthropy Australia.

Philanthropy Australia does however recognise that additional oversight of charities undertaking activities overseas is necessary and important. We therefore recommend the introduction of External Conduct Standards under Division 50 of the *Australian Charities and Not-for-profits Commission Act 2012* (Cth), which would provide the ACNC with the ability to monitor charities undertaking activities overseas more effectively, to ensure that charities are properly accountable and that funds are used for charitable purposes.

A DGR Category for Community Foundations

Community foundations are community-owned, not-for-profit, charitable organisations which exist for public benefit in a specific, named geographic area. Their purpose is to attract resources to support and revitalise local communities and build social capital. They make philanthropic grants, and often seek to build a perpetual financial asset for their community.

They are managed by voluntary boards and may have input from advisory committees from the local area. Many community foundations also employ a small number of staff, often only one or two paid employees supported by volunteers. They have multiple sources of funding from a range of donors and supporters.

Community foundations are a valuable and unique form of community infrastructure, which seek to empower communities to address local challenges themselves. They operate at the grassroots level to understand community needs at the frontline, and apply their expertise and experience to make better grants. They act as a leader, connecter, convenor and funder within communities and encourage civic engagement, volunteering and philanthropy.

Currently, our tax laws make life very hard for community foundations and this is holding back their growth and their impact. This means that community foundations cannot make the fullest possible contribution to their communities.

Community foundations generally operate a 'public ancillary fund' (an 'Item 2' DGR) – this imposes considerable and burdensome restrictions on their operations

Community Foundations Cannot Accept Donations from 'Private Ancillary Funds'

Private ancillary funds are one of the most common forms of private foundation, however because they are also an 'Item 2' DGR, community foundations cannot accept donations from them – this cuts community foundations off from a significant source of philanthropic funding, but also precludes private ancillary funds from leveraging the local experience and expertise of community foundations.

Case Study – the Fremantle Foundation (Fremantle, Western Australia)

A large Melbourne based private ancillary fund wished to support social inclusion initiatives in Western Australia. They were interested in contributing to the Fremantle Foundation, which in turn would distribute the funds towards social inclusion initiatives in the local area more effectively by using its knowledge and understanding of community needs. However, because of limitations in the tax laws, the private ancillary fund was unable to distribute to the Fremantle Foundation. This meant the local community missed out on the support from the private ancillary fund, and the private ancillary fund missed out on leveraging the Fremantle Foundation's local experience and expertise.

A newly released report, *Collective Giving and its role in Australian Philanthropy*[5], commissioned by the Australian Government's Department of Social Services on behalf of the Prime Minister's Community Business Partnership, identifies the inability of Private Ancillary Funds to give to community foundations as a barrier to the growth of collective giving groups in Australia. Collective giving groups are often hosted by community

[5] See: http://www.communitybusinesspartnership.gov.au/about/research-projects/collective-giving-and-its-role-in-australian-philanthropy/

foundations, and the report notes that:

> *'If PAFs could give to community foundations, this would open a whole new source of funding for collective giving groups – there are over 1,400 PAFs in Australia, and they gave over $300 million in 2013-14. These funds could be used for a variety of purposes, such as:*
>
> - *providing funding to support start-ups and potentially accelerate the rate new collective giving groups are forming*
> - *providing capacity building grants to build ongoing sustainability, and*
> - *increasing the level of donations made to collective giving groups, for example through 'matching initiatives' where a PAF agrees to donate a certain amount to a giving circle provided it is 'matched' by smaller donors.*

Whilst collective giving groups are relatively new to Australia, this form of philanthropy has seen significant growth in the United States and the United Kingdom. By failing to address the barriers to their growth that exist within the current DGR framework, the Government risks missing an opportunity to encourage the development of collective giving in Australia.

In addition, according to Professor Jason Franklin, one of the world's leading experts on community and collective philanthropy and the W.K. Kellogg Community Philanthropy Chair at the Dorothy A. Johnson Center for Philanthropy at Grand Valley State University in the United States[6], the inability of Private Ancillary Funds to give to community foundations will be a barrier to the growth of so called 'funder collaboratives' which are another innovative way to undertake high impact strategic philanthropy. According to Professor Franklin[7]:

> *In the US, we're seeing the rise of funder collaboratives. This is an arrangement where foundations and individuals come together to pool their funds and adopt a coordinated and collaborative approach to addressing a particular issue. They allow for more strategic and impactful giving, which makes a bigger difference than foundations and individuals acting in isolation. Community foundations are playing a key role in supporting this innovative approach to philanthropy, as they often convene such funder collaboratives. They receive the funds from the foundations and individuals, provide advice and support for decision making by the funder collaborative, and then make grants based on these decisions. I have visited Australia on two occasions in the last year to learn about your philanthropic sector and think that Australian philanthropy, and your community foundations, are doing fantastic work. But it is clear that the taxation and regulatory framework makes life very difficult for your community foundations – based on my understanding, the current rules would make it very hard for funder collaboratives to grow in Australia. This will be a missed opportunity, and I would encourage the addressing of the current barriers which make it hard for community foundations to do their important work.*

Furthermore, and particularly relevant to the Fremantle Foundation case study set out above, Professor Franklin points out that:

> *Additionally, in the US community foundations serve as valuable partners for private foundations to provide small grant support, capacity building and training services, and other supports for charities working on shared issue priorities. That generally entails a private foundation making one or more grants directly to a community foundation to run programs or manage regranting programs, leveraging the networks and skills of*

[6] See: http://johnsoncenter.org/chairs-fellowships/kellogg/

[7] Comments provided to Philanthropy Australia

community foundation leaders. This has proven to be an effective partnership structure in the US, but one that is not viable in Australia at present given current DGR regulations. This is a second missed opportunity to advance the social service and change efforts undertaken by private and community foundations in Australia.

Community Foundations Can Only Make Grants to 'Item 1' DGRs

Community Foundations can only make grants to 'Item 1' DGRs, however in regional and rural areas there sometimes are not enough suitable 'Item 1' DGRs to grant to, making it difficult for community foundations to fulfil their mission and make a difference.

Case Study – the Stand Like Stone Foundation (Mt Gambier, South Australia)

To support a mental health and wellbeing program for young people on the Limestone Coast, the Stand Like Stone Foundation had to undertake a lengthy process through an intermediary to distribute funds, using up valuable time and money in the process.

Given these barriers, Philanthropy Australia believes that a new deductible gift recipient category within Division 30 of the *Income Tax Assessment Act 1997* (Cth) specifically for community foundations is needed.

We expect that the revenue forgone from the change would be minimal – it would therefore be an affordable reform, which is important given current budget constraints.

It could also be a lasting and tangible policy change outcome coming out of the Prime Minister's Community Business Partnership – reducing red tape and supporting community philanthropy and collective/collaborative giving in Australia.

4. Responses to Specific Consultation Questions

Strengthening Governance Arrangements

1. *What are stakeholders' views on a requirement for a DGR (other than government entity DGR) to be a registered charity in order for it to be eligible for DGR status. What issues could arise?*

   Philanthropy Australia supports a new requirement for a DGR (other than a government entity) to be a registered charity in order for it to be eligible for DGR status.

   We recommend that the new requirement commences at least one year from the commencement of the relevant legislative amendment, and that appropriate transitional support is provided by the ACNC to facilitate the registration process.

   There is a small number of ancillary funds which are not registered as a charity. We do not believe that requiring them to register as a charity raises any issues, provided appropriate transitional arrangements are put in place.

   Given that this proposal will result in additional charities falling within the ACNC's jurisdiction, it is vital that the ACNC is properly resourced to manage this additional workload.

2. *Are there likely to be DGRs (other than government entity DGRs) that could not meet this requirement and, if so, why?*

   Not that Philanthropy Australia is aware of.

3. *Are there particular privacy concerns associated with this proposal for private ancillary funds and DGRs more broadly?*

Philanthropy Australia does not believe that this proposal will present any privacy concerns for private ancillary funds or other DGRs.

The ACNC regulatory framework includes provisions and processes to enable the withholding of information from the ACNC Register in particular circumstances, such as where publishing the information could endanger public safety, or if, in the case of private ancillary funds, it is likely to identify an individual donor.

However, these provisions and processes as they apply to private ancillary funds need reform in order to decrease red tape imposed on private ancillary funds, whilst freeing up resources within the ACNC so they can be used for other purposes. This is the subject of a separate representation from Philanthropy Australia to the Australian Government.

4. *Should the ACNC require additional information from all registered charities about their advocacy activities?*

   Philanthropy Australia strongly opposes this proposal. Our reasons for this are set out in Section 3 of this submission.

5. *Is the Annual Information Statement the appropriate vehicle for collecting this information?*

   See answer to Question 4.

6. *What is the best way to collect the information without imposing significant additional reporting burden?*

   See answer to Question 4.

Reducing Complexity

7. *What are stakeholders' views on the proposal to transfer the administration of the four DGR Registers to the ATO? Are there any specific issues that need consideration?*

   Philanthropy Australia supports the transfer of the administration of the four DGR Registers to the ACNC and the ATO.

   There is no rationale for maintaining the existing arrangements, and we believe that the proposal will decrease red tape imposed on charities and decrease processing times for applications for endorsement as a DGR.

   One way to implement this change would be to have the ACNC determine whether an organisation meets the criteria for registration as a specific type of organisation, for example as an environmental or cultural organisation, with the ATO then providing endorsement for access to tax concessions.

   This would follow the current approach used to register Public Benevolent Institutions and Health Promotion Charities and provide endorsement for access to tax concessions. This approach has worked well and is therefore a good model upon which to base further changes.

   It is important that effective transitional arrangements are implemented to give effect to this proposal, and that the ACNC and ATO are properly resourced to manage the additional workload associated with the proposal.

   Longer-term, Philanthropy Australia believes that more comprehensive reform of the DGR framework is needed as recommended by the Not-for-profit Sector Tax Concession Working Group report *Fairer, simpler and more effective tax concessions for the not‑for‑profit sector* (May 2013) and discussed in Section 2 of this submission.

8. *What are stakeholders' views on the proposal to remove the public fund requirements for charities and allow organisations to be endorsed in multiple DGR categories? Are regulatory compliance savings likely to arise for charities who are also DGRs?*

Philanthropy Australia supports the removal of the public fund requirements for charities in their current form, and to allow organisations to be endorsed in multiple DGR categories. Both proposals will decrease red tape for charities.

Given the oversight role of the ACNC, there is no longer a need for the public fund requirements in their current form. However, some safeguards may still be necessary in the case of organisations which are only endorsed as a DGR for part of their activities.

For example, schools cannot be endorsed as a DGR however they may operate building and scholarship funds which can. Safeguards may be necessary to ensure that funds provided to building and scholarship funds are used for proper purposes. This may involve retaining requirements for such funds to maintain separate bank accounts and keep appropriate records of donations and how they are spent.

Allowing organisations to be endorsed in multiple DGR categories will decrease the complexity of the DGR framework, and assist charities which undertake a diversity of activities across a number of DGR categories.

Philanthropy Australia does question how this proposal will apply in the case of Public Benevolent Institutions and Health Promotion Charities. These charities require their principal purpose to be the relief of poverty or distress, or to promote the prevention or the control of diseases in human beings respectively. Would such charities be permitted to be endorsed in multiple DGR categories, provided their principal purpose is unchanged?

Integrity

9. *What are stakeholders' views on the introduction of a formal rolling review program and the proposals to require DGRs to make annual certifications? Are there other approaches that could be considered?*

Philanthropy Australia believes that the transparency and accountability of DGRs is important, and that DGRs are endorsed in accordance with their entitlements under the law.

However, we do not believe that the introduction of a formal rolling review program is necessary to achieve this, as we are of the view that existing arrangements are sufficient to ensure compliance with the law.

The ACNC and the ATO already have powers to undertake compliance reviews where they believe they are warranted to ensure compliance with the law, and it is not apparent that introducing new and potentially costly formal review processes is necessary.

Rather, we believe that it should be for the ACNC and the ATO to determine whether a compliance review of a particular cohort of charities and/or DGRs is necessary, with these decisions informed by an assessment of identified compliance risks and systemic issues.

Isolated instances of non-compliance would be unlikely to justify undertaking a review, however if there is evidence of broader non-compliance and compliance risk thresholds have been reached then this could justify undertaking a review of the particular cohort of charities and/or DGRs.

Given the ACNC's reporting framework, the ACNC and the ATO have the ability to identify such risks and issues based on the information provided through the Annual

Information Statement, and can also undertake other strategic assessments to inform their decisions.

We would encourage the Government to ensure that the ACNC and ATO are properly resourced to undertake necessary compliance activities.

Philanthropy Australia does support a requirement for DGRs to certify that they meet DGR eligibility requirements as part of completing their Annual Information Statement.

10. *What are stakeholders' views on who should be reviewed in the first instance? What should be considered when determining this?*

As discussed in the answer to Question 9, the need for any review should be determined by the ACNC and the ATO and be informed by an analysis of identified compliance risks and systemic issues.

11. *What are stakeholders' views on the idea of having a general sunset rule of no more than five years for specifically listed DGRs? What about existing listings, should they be reviewed at least once every, say, five years to ensure they continue to meet the 'exceptional circumstances' policy requirement for listing?*

Specifically listed DGRs are necessary because of the inadequacy of the existing DGR framework. For example, Philanthropy Australia is a specifically listed DGR because despite our purpose of promoting and encouraging more and better philanthropy in Australia, we would are not eligible for DGR status other than through a specific listing. There are various other organisations in a similar situation to Philanthropy Australia.

If the recommendation made in the Not-for-profit Sector Tax Concession Working Group's report *Fairer, simpler and more effective tax concessions for the not-for-profit sector* (May 2013) to expand access to DGR status (as discussed in section 2 of this submission) were adopted, the need for specific listings would be diminished. However until such reform occurs, exceptional circumstances will exist which justify specifically listing certain organisations as DGRs.

In the absence of such reform, Philanthropy Australia does not support the introduction of a general sunset rule for specifically listed DGRs. It is already open to the Australian Government to provide a specific listing for a limited time period, and this already occurs in certain instances where the Government believes that a permanent listing is not necessary.

A general sunset rule would merely increase the red tape burden on organisations with a DGR specific listing, as they would need to re-apply for a specific listing, which can be a complex and time-consuming process. Given the inadequacy of the existing DGR framework, in most cases, the exceptional circumstances which led to their specific listing in the first place would still exist, in which case the process for re-applying will have been an unnecessary exercise.

It is also already open to the Australian Government to direct the Treasury to review specifically listed DGRs. It is possible some are no longer in operation, in which case the justification for their specific listing would no longer exist and they should be removed from the legislation.

Philanthropy Australia does believe that there should be a requirement that a specifically listed DGR is registered as a charity, unless they are a government entity or there are other highly exceptional circumstances.

Registration as a charity would provide ongoing oversight of specifically listed DGRs, given the requirement for registered charities to report to the ACNC.

Philanthropy Australia is also of the view that there could be improved transparency and rigour around the process for obtaining a DGR specific listing. For example, an

independent panel could be established and given the task of making recommendations to the Australian Government regarding whether an organisation should be granted a specific listing. These recommendations would be made public, as would the decision of the relevant Minister regarding the application which is the subject of the recommendation. Such a new framework would improve confidence in the process.

12. *Stakeholders' views are sought on requiring environmental organisations to commit no less than 25 per cent of their annual expenditure from their public fund to environmental remediation, and whether a higher limit, such as 50 per cent, should be considered? In particular, what are the potential benefits and the potential regulatory burden? How could the proposal be implemented to minimise the regulatory burden?*

    Philanthropy Australia strongly opposes this proposal. Our reasons for this are set out in Section 3 of this submission.

13. *Stakeholders' views are sought on the need for sanctions. Would the proposal to require DGRs to be ACNC registered charities and therefore subject to ACNC's governance standards and supervision ensure that environmental DGRs are operating lawfully?*

    Requiring all environmental DGRs to be a registered charity, as proposed in paragraph 21 of the Discussion Paper, will mean that environmental DGRs will become subject to the *Charities Act 2013* (Cth) and will not be permitted to have disqualifying purposes such as the purpose of engaging in or promoting activities that are unlawful or contrary to public policy, or the purpose of promoting or opposing a political party or a candidate for political office.

    Where the ACNC considers that a registered charity has such a disqualifying purpose, it has a number of enforcement tools which it can use to ensure compliance with the law and ultimately may decide to deregister the charity where instances of non-compliance are serious and/or ongoing. Philanthropy Australia believes that the oversight and powers of the ACNC is sufficient in this regard, and that no further sanctions are necessary.

5. Other Relevant Matters

The current provisions with relation to section 50-50 of the *Income Tax Assessment Act 1997*, place unnecessary compliance risk on charities, despite the introduction of the ATO's Public Ruling 2015/1, through imposing governing rules and sole purpose conditions.

The special conditions were enacted, with effect from 1 July 2013, in *Tax Laws Amendment (2013 Measures No 2) Bill 2013*. These conditions require that an entity:

a) comply with all the substantive requirements in its governing rules; and
b) apply its income and assets solely for the purpose for which the entity is established (the solely condition).

The key concerns with these conditions include:

- If a purpose is incidental or ancillary to the original purpose for which a charity is formed, it is arguable that the charity may fail the 'solely' condition. This is the plain and ordinary meaning of the word 'solely'.
- For not-for-profits (NFPs) that are not charities, the sole purpose requirement is not the correct test and the 'dominant' purpose requirement has been accepted by the Courts. The enactment of the special conditions has fundamentally altered the basis on which income tax exemption for NFPs is determined.
- For the governing rules condition, it is difficult to say that any legislative requirement is not substantive.

- Both the governing rules condition and the solely condition operate with a guillotine effect, in the sense that (a) it is not possible to 'largely' or 'mostly' comply with the substantive requirements in the governing rules; and (b) the 'solely' condition will be failed wherever there is a misapplication of income or assets, irrespective of intention or amount.
- If some form of formal review process is introduced, as the Discussion Paper proposes, the current wording of section 50-50 means that there is a high risk that many charities and DGRs could lose their endorsement given the very narrow drafting of the section.
- For example, a charity which also runs a for-profit business to generate income which is used to further their charitable purpose could fail the 'apply its income and assets solely for the purpose for which the entity is established' test and hence lose access to tax concessions associated with being a registered charity.

For this reason, Philanthropy Australia believes that it is important that any reform of the DGR framework also include reform to section 50-50 of the Income Tax Assessment Act 1997. Such reforms should involve:

- Repealing the governing rules condition
- Including a new provision that says, for the avoidance of doubt, that the 'solely' condition is not breached where an entity pursues purposes or conducts activities that are incidental or ancillary to a purpose for which the entity is established