August 1, 2017

Senior Adviser
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By email: DGR@treasury.gov.au

Dear Senior Adviser,

Tax Deductible Gift Recipient – Reform Opportunities

Thank you for the opportunity to provide a submission to the Treasury in relation to the Discussion Paper dated 15 June 2017, regarding potential reforms to the Deductible Gift Recipient (DGR) tax arrangements. My submission provides comments in relation to issues 1–7.

Issue 1: Transparency in DGR dealings and adherence to governance standards

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?

Requiring all DGRs (other than government entities) to be registered with the ACNC as a prerequisite to obtaining endorsement as a DGR by the ATO would be an important first step in improving DGR governance and accountability. It would also reduce some of the complexity around eligibility requirements for DGR status.[1] The ACNC's jurisdiction would need to be extended to cover non-charitable DGRs.

The next step for consideration would be extending DGR status to all charities registered with the ACNC, subject to endorsement restrictions that limit the eligible activities for use of DGR funds.[2] In doing so, Australia would be more aligned with other common law jurisdictions, such as the US, UK and Canada, where charities are generally eligible to receive tax deductible gifts.[3]

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

Most DGRs would be able to meet the ACNC registration requirements. As stated above, the

[1] See Not-for-profit Sector Tax Concession Working Group, *Fairer Simpler and More Effective Tax Concessions for the Not-for-Profit Sector* (Treasury, Final Report, May 2013) 23.
[2] Ibid 24–26.
[3] For individuals in Canada and the UK, the tax concession for a charitable donation is a tax credit.

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ACNC's jurisdiction would need to be extended to cover non-charitable DGRs. Registration with the ACNC would provide benefits to these organisations, such as providing them with access to ACNC educational resources and guidance.

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

While there may be some privacy concerns for PAFs in particular, from a public policy perspective these concerns are outweighed by the need for transparency and accountability. This has been long recognised in the US, where all charitable organisations (or 501(c)(3) organisations) other than religious charities, must file annual IRS information returns (Form 990s). These returns are available to the public.

Private foundations, being a unique class of 501(c)(3) organisation, are required to submit a specific annual information return, the Form 990-PF,[4] which are also publicly available. This document provides fiscal data for the foundation, names of trustees and officers, application information, and a complete grants list. Similarly, in Australia, there could be a specific annual information return for PAFs.

Issue 2: Ensuring that DGRs understand their obligations, for example in respect of advocacy

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

Under the *Charities Act 2013* (Cth), Australian charities can undertake advocacy in furtherance of their charitable purposes.[5] This was established in *Aid/Watch Incorporated v Commissioner of Taxation*,[6] where the High Court of Australia determined that advocacy is a legitimate activity for charities, whether in furtherance of their charitable purposes or as a purpose in its own right if it furthers another charitable purpose.

As charity law focuses on purposes not activities, the main concern with advocacy is where the charity has a *purpose* of promoting or opposing a particular political party or candidate, or a *purpose* of engaging in or promoting activities that are unlawful or contrary to public policy. Outside of these disqualifying *purposes*, Australian charities are free to engage in advocacy covering a wide range of activities.[7] Advocacy activities undertaken by environmental DGRs that are 'out of step with the expectations of the broader community' (para 15 of the Discussion Paper) are unlikely to constitute a disqualifying purpose.

Requiring additional information from *all* registered charities about their advocacy *activities* would amount to significant regulatory and administrative overreach. At a minimum, this would create a considerable administrative burden, but more importantly it could have a chilling effect on the ability of charities to make important contributions to public debate and public policy. This reporting requirement would also be considerably more onerous than in other common law jurisdictions. For example, in the US the annual Form 990 information statement contains one question on advocacy that asks whether a charity has engaged in lobbying activities.[8] If a charity

[4] See <https://www.irs.gov/pub/irs-pdf/f990pf.pdf>.
[5] *Charities Act 2013* (Cth) s 12(1)(l).
[6] *Aid/Watch Incorporated v Commissioner of Taxation* (2010) 241 CLR 539.
[7] See <http://www.acnc.gov.au/ACNC/Reg/Charities_elections_and_advocacy_.aspx>.
[8] See Form 990, Part IV, Question 4 <https://www.irs.gov/pub/irs-pdf/f990.pdf>.

answers yes, then it must furnish additional information by submitting a schedule on political campaign activities and lobbying activities (as defined in the schedule).[9] This is very different from a general requirement for all charities to submit information on 'advocacy activities'.

5. Is the Annual Information Statement (AIS) the appropriate vehicle for collecting this information?

The AIS is an appropriate vehicle for collecting information from registered charities. However, as noted above, there are a number of issues with a general reporting requirement for advocacy activities. Therefore it would not be appropriate to use the AIS for this purpose.

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

Collecting information from all registered charities about their advocacy activities would impose significant additional reporting burdens and, for the reasons stated above, could also lead to more harmful unintended consequences.

Issue 3: Complexity for approvals under the four DGR registers

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?

Transferring administration of the four DGR registers to the ATO would significantly reduce administrative complexity and promote consistency. However, such a transfer raises the following issues.

1. Additional Resources for the ATO

Achieving administrative synchronisation of the four registers would require significant additional resources be provided to the ATO. The Australian National Audit Office's (ANAO) independent performance audit of the ATO's administration of DGRs found that the ATO faced a number of challenges in assessing the extent to which organisations complied with the requirements of DGR status, largely due to limited resources.[10] With the recent reductions in ATO budget and staff, there would have to be a renewed commitment by government to provide resources for the ATO to administer the four registers.

2. Legislative Amendments

The operation of the four registers is based on legislative provisions that apply to the four categories of organisations seeking to qualify for DGR status. As a result, administrative synchronisation would require legislative amendments, providing an opportunity to achieve consistency in the legislative provisions. In my PhD thesis,[11] I examined two of these registers in detail: the Overseas Aid Gift Deduction Scheme (OAGDS) and the Register of Environmental Organisations (REO).

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[9] See Schedule C <https://www.irs.gov/pub/irs-pdf/i990sc.pdf>.
[10] Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-Profit Sector)' (Audit Report No 52, Australian Government, 2011), 20–21. ('*ANAO Audit Report No 52*').
[11] Natalie Silver, *Beyond the Water's Edge: Re-thinking the Tax Treatment of Australian Cross-border Donations* (PhD Thesis, Queensland University of Technology, June 2016) <https://eprints.qut.edu.au/97528/>.

Overseas Aid Gift Deduction Scheme

The OAGDS considers applications from organisations seeking to establish overseas aid funds and is administered by DFAT. Overseas aid funds are provided for in sub-div 30-B of the *Income Tax Assessment Act 1997* (Cth) (*ITAA 1997*) under the category of international affairs.[12] There are four legislative requirements under the *ITAA 1997* that must be met in order to qualify as an overseas aid fund. The fund must be:

(i) a public fund;
(ii) a charity registered with the ACNC or operated by one;
(iii) established by an organisation declared by the Minister for Foreign Affairs to be an 'approved organisation' (as defined in the *OAGDS Guidelines*[13]); and
(iv) established and maintained solely for the relief of people in a country declared by the Minister for Foreign Affairs to be a developing country.

The process of becoming an overseas aid fund is lengthy. The first step is applying for 'approved organisation' status through DFAT, which then recommends to the Minister for Foreign Affairs that that the applicant be an 'approved organisation'. Once this is established, the ATO assesses the application for DGR endorsement to ensure that the four requirements in the *ITAA 1997* have been met. The ATO then seeks approval from the Treasurer that the fund be declared a developing country relief fund. Once approved, the Treasurer declares by notice in the Commonwealth Government Gazette that the fund is a developing country relief fund. The ANAO's efficiency audit determined that this process can take up to two years to complete.[14] DFAT's 2015 review of the OAGDS highlighted the need for change to its onerous requirements and processes. In particular, the complexity of the application process and the resourcing toll it takes on organisations, particularly when compared to the process of obtaining tax deductible status in other OECD countries.[15]

Once an organisation has achieved DGR status through the OAGDS, there appears to be minimal ongoing regulation of cross-border activities and donations. While these DGRs must be registered with the ACNC, the AIS contains little information on cross-border activities and their financing. Indeed, evidence suggests that overseas aid funds are engaged in auspicing — entering into third party arrangements to assist other non-profit organisations to channel tax-deductible donations overseas often for a servicing fee.[16] As a result, recommendation 8 of the House of Representatives Standing Committee on the Environment (Discussion Paper para 80), that the Commonwealth Treasury in consultation with the ATO review provisions in the *ITAA 1997* prohibiting conduit behaviour, also needs to be addressed in relation to overseas aid funds.

The proposed transfer of the OAGDS from DFAT to the ATO would require sub-div 30-B of the *ITAA 1997* be amended to remove requirements (iii) and (iv) above. If the public fund requirements are removed as proposed in the Discussion Paper, then requirement (i) would also

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[12] *ITAA 1997* s 30-80(1) item 9.1.1, s 30-85.
[13] Department of Foreign Affairs and Trade, *Overseas Aid Gift Deduction Scheme: Guidelines for Obtaining Tax Deductibility* (2014).
[14] See *ANAO Audit Report No 52*, above n 7, 109 [4.41].
[15] Ibid 7–8.
[16] The Australian Bureau of Statistics estimated that of $5.7 billion in grants and other payments made by non-profits to others, A$1.03 billion (18%) went to 'nonresident organisations', defined as any organisation domiciled overseas. Australian Bureau of Statistics, 'Australian National Accounts: Non-Profit Institutions Satellite Account, 2012–13' (Catalogue No 5256.0, 28 August 2015) table 10.1 <http://www.abs.gov.au/AusStats/ABS@.nsf/MF/5256.0>.

need to be removed. This provides an opportunity for the ATO and the ACNC to ensure that overseas aid funds are subject to appropriate oversight and monitoring (see below).

Register of Environmental Organisations

The REO is administered by the Department of the Environment in consultation with the ATO. For an organisation to be entered on the REO, it must satisfy six requirements in sub-div 30-E of the *ITAA 1997*. The fund must:

(i) be a body corporate, a cooperative society, a trust, or an unincorporated body established for a public purpose by the Commonwealth, a state or a territory; [17]

(ii) have a principal purpose of protecting and enhancing the natural environment or a significant aspect of it, providing information or education, or carrying out research about the natural environment or a significant aspect of it; [18]

(iii) maintain a public fund to receive gifts for its principal purpose and complies with any Ministerial rules to ensure that gifts made to the fund are used only for its principal purpose; [19]

(iv) not give any of its property, profits or financial surplus to its members, beneficiaries, controllers or owners; [20]

(v) have a policy of not acting as a mere conduit for the donation of money or property;[21] and

(vi) provide statistical information about donations and gifts to the Environment Secretary each financial year. [22]

In addition to these legislative requirements, there is a lengthy admission process for inclusion on the REO. The first step is applying to the Department of the Environment, which carries out an initial assessment of all applications to ensure that the organisations meet the legal requirements in the *ITAA 1997* and the administrative requirements in the *REO Guidelines*.[23] Once the Department has determined that the applicant has met these requirements, it is passed to the Treasurer for ATO approval. The ANAO's efficiency audit determined that this process can take more than 18 months. [24]

Once listed, these environmental DGRs are required to submit annual information statements, including audited financial statements.[25] In addition, pursuant to requirement (v) above, they are prohibited from serving as a conduit to channel funds for another entity operating overseas. As noted by the House of Representatives Standing Committee on the Environment (Discussion Paper paras 80-83), this requirement is not currently being met by all environmental DGRs.

The proposed transfer of the REO from the Department of the Environment to the ATO would require sub-div 30-E of the *ITAA 1997* to be amended to remove requirement (vi) above. If the public fund requirements are removed as proposed in the Discussion Paper, then requirement (iii) would also need to be removed. Requiring environmental DGRs to be registered with the ACNC (per issue 1 above) would obviate the need for a separate annual information statement.

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[17] See *ITAA 1997* s 30-260.
[18] Ibid s 30-265(1).
[19] Ibid s 30-265(2), (4).
[20] Ibid s 30-270(1).
[21] Ibid s 30-270(2).
[22] Ibid s 30-270(4).
[23] See Australian Government, *Register of Environmental Organisations: A Commonwealth Tax Deductibility Scheme for Environmental Organisations – Guidelines* (2008) ('*REO Guidelines*').
[24] See *ANAO Audit Report No 52*, above n 7, 108–9 [4.38]–[4.41].
[25] See *REO Guidelines*, 10–11.

Instead, specific questions for environmental DGRs (if deemed necessary) could be incorporated into the ACNC's AIS.

3. ACNC Regulatory Oversight for DGRs

Transferring the administration of the four DGR Registers to the ATO will reduce administrative complexity and promote legislative consistency. At the same time, it provides an opportunity to address the regulatory issues concerning a lack of oversight and monitoring of these DGRs. The ACNC is well positioned to undertake the necessary supervision, particularly through its registration and reporting requirements, which may need to be modified to obtain more comprehensive information on these DGRs.

For overseas aid funds and environmental DGRs operating overseas, further oversight could be provided through the development of the ACNC's external conduct standards to regulate charities sending funds or engaging in activities outside of Australia, as provided for in the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (*ACNC Act*). The ATO could assist the ACNC through its auditing capabilities, with AUSTRAC providing additional oversight of cross-border transactions. These regulatory mechanisms would serve to mitigate the risks of charities being used for tax abuse and terrorist financing purposes, and reduce the use of these DGRs as conduits, providing greater transparency and accountability of cross-border charitable activities.

Additional regulation of charities operating overseas is critical given that the law applying to these charities is currently in a state of flux. As the sector awaits the ATO's public ruling on the 'in Australia' issue, many organisations are taking advantage of the existing legal vacuum and establishing public benevolent institutions (PBIs) with DGR status that have purposes and beneficiaries overseas. This recent development has enabled these PBIs and their donors to engage in tax effective cross-border charity and philanthropy. At the same time, it requires that appropriate regulatory mechanisms be put in place to provide ongoing monitoring of these cross-border charitable funds and activities.[26] It also raises the larger question of whether there should be a general rule of allowing Australian charities operating overseas to obtain DGR status and removing the categories of exceptions, making all Australian charities operating overseas subject to the same legal and administrative requirements.

Issue 4: Complexity and red tape created by the public fund requirements

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?

Removing the public fund requirements and allowing organisations to be endorsed in multiple DGR categories would reduce some of the complexity associated with obtaining DGR status.

Issue 5: DGRs endorsed in perpetuity, without regular and systemic review

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?

[26] For further discussion of this issue, see Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr, 'Delineating the Fiscal Borders of Australia's Nonprofit Tax Concessions' (2016) 14(3) *ejournal of Tax Research* 741, 763–4.

If all DGRs are required to be registered charities, incorporating DGR certifications into the ACNC's AIS would streamline reporting.

Implementing rolling reviews would require that substantial resources be provided to the ACNC and/or the ATO, depending on which agency was responsible for conducting these reviews. For example, the Canada Revenue Agency has a rigorous review program, auditing about 1% of charities per annum, which translates into approximately 800-900 registered charities across Canada each year.[27]

Instead of adopting rolling reviews that impact all DGRs, it would be better to adopt a risk-based approach. This involves prioritising compliance reviews undertaken by the ACNC and the ATO in accordance with an assessment of the risks posed by DGRs. This approach has been adopted by the Charity Commission of England and Wales and Her Majesty's Revenue and Customs in the UK, where charities are generally selected for review on a 'risk' basis, with a number also selected randomly.[28] Through its registration and reporting processes, the ACNC is well-positioned to assess compliance risks.

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

It is important to identify 'at risk' charities for an initial review, consistent with a risk-based approach to regulation. Considerations may include anything that would bring into question entitlement to charitable tax concessions, such as applying funds for non-charitable purposes.

Issue 6: Specific listing of DGRs by Government

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?

The process of listing organisations by name in the tax law has long been acknowledged as problematic in that it is arbitrary, inequitable and non-transparent.[29] In addition, those organisations that succeed in becoming specifically listed DGRs are subject to relatively little oversight and monitoring, other than a provision which enables the Commissioner to require a specifically listed DGR to provide information in order to determine if it continues to be eligible for DGR status.[30] For example, organisations that are listed as DGRs under the category of 'international affairs' in s 30-80(2) of the *ITAA 1997* are not only exempt from the 'in Australia' requirements, but unlike overseas aid funds their overseas activities are not limited to development or relief work and their beneficiaries are not confined to particular countries

[27] See <http://www.cra-arc.gc.ca/chrts-gvng/chrts/dtng/dt-prcss-eng html>.
[28] See Charity Commission of England and Wales, *Risk Framework* (February 2016) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/568897/Risk_framework_2016.pdf>; HMRC, *Guidance: Audits by HMRC Charities* (April 2016) <www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-7-audits-by-hmrc-charities>.
[29] See Commonwealth, *Parliamentary Debates*, Senate, 9 June 1989, 3766–7. See also Not-for-profit Sector Tax Concession Working Group, above n 1, 23.
[30] *Taxation Administration Act 1953* (Cth) s 353-20.

provided they continue to operate for their principal purpose and comply with any conditions made by the government on listing as a DGR. [31]

As part of the process of DGR reform, it is crucial that government address the lack of regulatory oversight for specifically-listed DGRs, which makes them susceptible to tax abuse. While a general sunset rule would be a first step towards achieving greater accountability, this does not go far enough to ensure transparency of specifically-listed DGRs. If a key objective of the DGR reforms is to more effectively assess and monitor DGRs by strengthening governance arrangements, specifically-listed DGRs should not be exempt from ACNC oversight, including registration and reporting requirements.

Issue 7: Parliamentary Inquiry into the Register of Environmental Organisations

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?

Under the *ITAA 1997*, to be entered on the REO, an organisation must have a principal purpose of protecting and enhancing the natural environment or a significant aspect of it, providing information or education, or carrying out research about the natural environment or a significant aspect of it.[32] There is no requirement for environmental DGRs to commit a percentage of their annual expenditure from their public fund to environmental remediation, so this would require legislative amendment. In order to provide evidence of compliance, environmental DGRs would have to expend additional resources, as would the regulators assessing compliance.

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?

If registered with the ACNC, it would be inequitable and inefficient to impose additional sanctions on environmental DGRs that do not apply to other registered charities. As part of the registration process, these environmental organisations are required to comply with the ACNC's governance standards, 'to remain charitable, operate lawfully, and be run in an accountable and responsible way'.[33] To register as a charity, these organisations are also not permitted to have any disqualifying purposes (as outlined in issue 2 above). Non-compliance may result in enforcement action by the ACNC Commissioner.[34] Additional sanctions for a particular subset of DGRs would constitute regulatory overreach.

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Thank you for the opportunity to make a submission in relation to the Discussion Paper regarding potential reforms to the DGR tax arrangements. I am happy to be contacted to discuss this submission and look forward to the release of further iterations of the proposed reforms.

[31] See ATO, 'GiftPack for Deductible Gift Recipients & Donors' (NAT 3132, 2012).
[32] *ITAA 1997* s 30-265(1).
[33] *ACNC Act* s 50-5.
[34] *ACNC Act* s 45-5, note 1.

Sincerely,

/s/ Natalie Silver

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