

27 January 2012

The Manager  
Philanthropy & Exemptions Unit  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sir

**Re: The Treasury's Consultation Paper (2012) – Exposure Draft, Australian Charities and Not-for-profit Commission Bill 2012 ('the Exposure Draft')**

Further to our submission dated 9 December 2011, in relation to the government's proposed statutory definition of 'charity', we take this opportunity to respond to the Treasury's consultation on the Exposure Draft.

We are in favour of the promotion of public trust and confidence in the sector, through improved governance, accountability and transparency<sup>1</sup>. However, we are concerned at Treasury's 'tokenistic' approach to a true public consultation process, particularly having regard to the 'materiality' of many of the reforms proposed by the Exposure Draft. Significantly, the reforms include, displacing the commonly accepted and judicially considered concept of 'non-profit', which presently permits 'activities', such as commercial activities, to be undertaken with the purpose of generating a profit, without this affecting the charitable status of the entity, provided that the profits are directed towards the charitable purpose of the entity.

The Treasury has repeatedly stated that the overarching policy objectives of the not-for profit ('NFP') reforms are to '*deliver smarter regulation for the sector, removing regulatory complexity and duplication and reducing red-tape for NFP's*'. However, in

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<sup>1</sup> The Exposure Draft, states at Division 2, that "*The Object of this Act is to promote public trust and confidence in the not-for-profit entities that provide public benefits. To further this object, (a) this Act aims to: (i) promote the good governance, accountability (to donors, to governments and the public generally) and transparency of such entities (including through the provision of educational information to them and the provision of information to the public about them); and (ii) minimise regulatory duplication and simplify such entites' interactions with governments; and ...*".

our view, the Treasury has been illusive as to the specific policy rationale for many of the proposed measures, which include:

- displacing High Court decisions which support the on-going independence and economic sustainability of the sector;
- unsupported claims concerning 'fiscal favours' attaching to NFP tax concessions & competitive neutrality; and
- controlling entry into the NFP sector, by strict reference to the methods of achieving a 'charitable purpose'.

We discuss each of these concerns briefly below.

**1. Displacing the High Court decisions which support the on-going independence and economic sustainability of the sector**

Under the existing regime, a 'non-profit' organisation is an organisation that is not operating for the profit or gain of its individual members, whether these gains would have been direct or indirect. This applies both while the organisation is operating and when it winds up<sup>2</sup>. The term 'non-profit' does not imply that a charitable entity will not generate a profit nor, preclude the distribution of such profits to charitable entities<sup>3</sup>. Significantly, the High Court in the Word Investments decision, affirmed that a company which raised funds exclusively for supporting exempt charities was itself charitable'. The fact that the company raised funds through a commercial enterprise did not preclude it from being a charity<sup>4</sup>.

**1.1. Which NFP entities will be eligible for registration as a 'Charity' under the reforms proposed by the Exposure Draft?**

Under the proposed regime, all applicants who are seeking registration as a charity must first qualify as a 'not-for-profit' entity.

**1.2. The meaning ascribed to 'not-for-profit' does not appear in the Exposure Draft. However, it is stated in the Explanatory Materials that the ACNC will apply the definition of 'not-for-profit' as set out in the Government's measure to restate and standardise the special conditions for tax concession entities to determine if applicants are NFP's<sup>5</sup>.**

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<sup>2</sup> Australian Taxation Office: Tax Basics Guide for Non-profit-organisations (NAT 7966. 06.2011).

<sup>3</sup> Incorporated Council of Law Reporting of the State of Queensland v Commissioner of Taxation (1971) 125 CLR 659.

<sup>4</sup> *Federal Commissioner of Taxation v Word Investments* (2008) 236 CLR 204.

<sup>5</sup> The Treasury's Exposure Draft, *In Australia Special Conditions for Tax Concession Entities* (2011).

1.3. Chapter 2 of the Exposure Draft, sets out the criteria for registration as a 'charity'. Pursuant to Division 5-10 (1A) of the ACNC Bill, the first criterion is that the applicant is a '*not-for-profit*' entity.

**1.4. *Standardising the definition of 'Not for profit'***

Specifically, clause 1.4 of the Explanatory Material to the Exposure Draft states that:

1.4 "an entity will be entitled to be registered by the ACNC if it:  
  
*Is a not-for-profit entity;*  
  
*- as defined in the Government's measure to restate and standardise the special considerations for tax concession entities.*  
  
*- ..."*

1.5. Further on at clause 1.13 it is stated:

1.13 "A(n) entity will only meet the definition of NFP if it:  
  
*- does not carry on its activities for the purposes of profit or gain for particular entities, including its owners or members, either while it is operating or upon winding up; and*  
  
*- does not distribute its profits or assets to particular entities, including its owners or members, either while it is operating or upon winding up.*

1.6. The alteration to the widely accepted and applied meaning of 'non-profit' to 'not-for-profit' was first proposed by the Treasury in the 'In Australia' Special Conditions for Tax Concession Entities, consultations relating specifically to the *Exposure Draft of the Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) (2011)*. The Treasury has already received considered academic and sectoral criticisms for the strict conditions that the new definition will have on deductible gift recipients and the restrictions on distributions to other entities.<sup>6</sup>

<sup>6</sup> See: University of Melbourne Law School - Not-for-profit Project, Submission to the Treasury '*In Australia Special Conditions for Tax Concession Entities (Exposure Draft)*' and PilchConnect submission, dated 19 August 2011. Queensland University of Technology (2011), '*Not for profit income tax exemption: Is there is hole in the bucket, dear Henry*', Myles McGregor-Lowndes, Matthew Turnour and Elizabeth Turnour.

- 1.7. We do not propose to reiterate what has already been succinctly stated in earlier submissions to Treasury:  
[http://tax.law.unimelb.edu.au/files/Submission to Treasury in Australia Special Conditions final for upload.pdf](http://tax.law.unimelb.edu.au/files/Submission%20to%20Treasury%20in%20Australia%20Special%20Conditions%20final%20for%20upload.pdf)
- 1.8. However, the ambiguous nature of the term '*particular entities*', begs the question: '**To which 'class or persons/beneficiary' is the term '*particular entities*' referable?**'
- 1.9. It is foreseeable that without the benefit of a distinct definition to clarify what is in fact a '*particular entity*', the new Regulator would be at liberty to apply the term in a highly restrictive manner, which might be inconsistent with the finding by the High Court in *Word Investments*<sup>7</sup>.
- 1.10. We suggest Treasury clarify whether, under the new regime, it will remain compatible for a 'not-for-profit' with deductible gift registry status, to carry on commercial activities or make investments, in order to maximise the income available for it to carry on its own charitable purpose?
- 1.11. Without a definition of '*particular entity*', or an understanding of the tax reforms that will coincide with the proposed NFP reforms, it is difficult for the sector to position itself for the most efficient and cost-effective application of its funds.
- 1.12. Although the influence of the proposed NFP reforms on the activities of the not-for-profit sector is uncertain, what is readily foreseeable is the opportunity for recouping of revenue forgone, by way of abolition of existing NFP tax concessions available to '*particular entities*'. This measure, together with the potential additional revenue to be raised from the possible application of company tax to formerly income tax exempt entities, would increase the revenue<sup>8</sup>?

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<sup>7</sup> *Federal Commissioner of Taxation v Word Investments* (2008) 236 CLR 204.

<sup>8</sup> The EM to the ACNC Bill at page 3, states that the "*financial impact is \$53.6 million for the establishment of the ACNC and related structural changes to the Australian Taxation Office during the period 2011 – 2015. The establishment of the ACNC and related regulatory framework will result **in a small increase in compliance costs** in the short term. The exposure draft may involve some transitional compliance costs on the NFP sector in relation to setting up processes to comply with the new regulatory framework*".

- 2. Unsupported claims of 'fiscal favours' attaching to NFP tax concessions & competitive neutrality**
- 2.1. With reduced access to equity capital and the tax deductions such arrangements confer, many NFP organisations have sought to secure their sustainability, to enable their ongoing support to those who rely upon their specialised services<sup>9</sup>.
- 2.2. As with any 'for-profit' business, there are overheads and associated running costs, which require access to readily available cash-flow and ongoing financial support, which cannot be reliably or effectively sustained by government grants alone.
- 2.3. Consequently, the nature and scale of commercial activities which are undertaken by many charitable organisations has expanded and are no longer limited to local community enterprises such as opportunity shops. Indeed, some charitable organisations which carry-on commercial activities, may turn over an annual revenue well into the millions<sup>10</sup>.
- 2.4. One of the stated policy rationales for the removal of tax concessions to those NFP entities that carry on commercial activities in aid of their altruistic purposes, is to create a level playing field between the for-profit and not-for-profit sectors<sup>11</sup>. This policy measure appears to favour servitude to business interests, and unfairly distorting of the market in their favour.
- 2.5. Chapter 8 of the Productivity Commission Report 2010 was devoted to the consideration of 'competitive neutrality' and the conclusion was that on balance, income tax exemptions that apply to NFP's are not significantly distortionary. Similarly, the Henry Review stated that "*income tax and GST concessions generally do not appear to violate the principle of competitive neutrality where NFP organisations operate in commercial markets*"<sup>12</sup>.

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<sup>9</sup> Justice Sundberg of the Federal Court observed in the *Commissioner of Taxation v Word Investments Limited*: "*with the decline of the welfare state, charitable organisations are expected to do more with the same resources. Reliance on donations alone will, in many cases, be insufficient. Hence many charitable organisations have established business ventures to generate income necessary to support their activities*" [(2006) 64 ATR 483].

<sup>10</sup> The Productivity Commission Report 2010, the NFP sector contributes over 4% of GDP, with an additional \$14.6 billion of unpaid work contributed by nearly 5 million volunteers.

<sup>11</sup> Treasury, Better targeting of not-for-profit tax concessions (Consultation Paper, 27 May 2011).

<sup>12</sup> Australia's Future Tax System, Report to the Treasurer, December 2009, Part 2 Volume 1 of 2 at Page 209.

- 2.6. In our view, before any such limitations are placed on the availability of existing tax concessions for charitable organisations, there should be a proper investigation into the relevant principles of integrity and fairness within the income tax regime<sup>13</sup>. Such an investigation would include in its analysis, a bona fide assessment of the contribution of NFP's (its volunteers and those who contribute to the work of NFP's on minimal pay) which provide essential public goods and services which were once the responsibility of government.
- 2.7. The Treasury's should clearly explain, why it considers it necessary to apply such a 'heavy-handed' approach to not-for-profit reform? Is it the case that the Treasury's has in its sights, an opportunity to recoup the revenue expended in NFP tax concessions, to buffer the revenue expended on government funded activities?<sup>14</sup>.

The practical application and effect of many of the proposed reforms (which undoubtedly the Treasury has the wider policy objective of extending to the entire NFP sector) have not been adequately explained<sup>15</sup>. In this regard, we strongly urge the Treasury to delay the introduction of the ACNC Bill in its current form, until it can include all of the provisions which will be incorporated into the final Bill and explain, in a meaningful way:

- A. How the new regime will apply to 'charities' which propose to carry on a commercial enterprise for the benefit of its altruistic purpose? How will the generation of 'profit' by a charity, in furtherance of its altruistic purposes, affect its charitable status?
- B. How the laws introduced by the ACNC Bill will rectify any existing regulatory deficiency of the current legislative regime? and
- C. The consequential tax reforms that will coincide with the enactment of the final ACNC Bill together with the specific rationale for any proposed tax reform.
- D. How existing charities will be transitioned under the new regime, particularly if they fall outside the ACNC's proposed definition of 'not-for-profit' entity.

In the interests of good governance, proportionate and accountable decision-making, these measures, demand a thorough, robust and transparent public consultation well before any of the reforms are tabled in Parliament. Such consultation should be well

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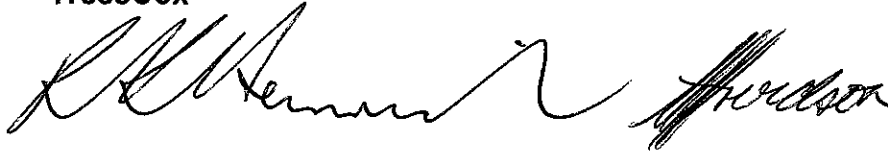
<sup>13</sup> An excellent article which may elicit clarity in the competitive neutrality debate, is that of Kerrie Sadiq and Catherine Richardson, '*Tax Concessions for charities: competitive neutrality, the tax base and 'public goods' choice*', (2010) 25 Australia Tax Forum.

<sup>14</sup> See attached Table 1.2 to the ANAO Audit Report No. 52, 2010 – 2011, Administration of Deductible Gift Recipients (Not for profit sector).

<sup>15</sup> Treasury's Not-for-profit Reform Factsheet, 'The ACNC Exposure Draft Consequential Amendments' 9 December 2011.

supported by an independent evaluation of the social and economic cost/benefit of the proposed NFP reforms together with a clearly articulated and compelling policy rationale.

Yours faithfully  
**TressCox**



**R K Heinrich**  
**Partner**  
*Email: ron\_heinrich@tresscox.com.au*

**Nicola Arvidson**  
**Special Counsel**  
*Accredited Specialist Property*  
*Email: nicola\_arvidson@tresscox.com.au*

