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Dear Committee

Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012
Australian Charities and Not-for-profits Commission Bill 2012
Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill 2012

I preface my submission on these Bills by observing that it is unfortunate that members of the public are given just a few business days to make a contribution to ensuring Australia has a 'fit for purpose' regulatory framework to facilitate the nonprofit sector. With nearly 170,000 words in three Bills and Explanatory Memoranda, considerable time is needed to read the documents and understand their possible implications. Such a limited public consultation is not conducive of good decision making and is of particularly concern when placed beside the Auditor General's recent finding that federal government agencies could take up to two years to make a decision on some types of DGR applications.[1]

I raise only a few issues due to the length of time for consideration:

1. The proposed definition of 'not-for-profit entity' is problematic.
2. The ACNC RIS was flawed and did not provide adequate policy options.
3. Governance standards need to be included in this consultation process
4. Plain language drafting – 'responsible entity' and 'registered entity'

1. The proposed definition of 'not-for-profit entity' is problematic

This critical definition is flawed. Parliament needs to make its intention crystal clear to avoid unintended consequences, wasteful litigation and distorted behaviour. It is not enough to tinker with the EM. The words of this statutory foundation stone of the regulatory regime need to be appropriate and concise.

The Bill provides that, to be entitled to income tax exemption, an entity must be a 'not-for-profit entity'.[2] Under the Bill, this will mean an entity that:[3]

[1] Auditor-General (2010) *Administration of Deductible Gift Recipients (Non-profit Sector): Australian Taxation Office* (Australian National Audit Office, Audit Report No 52, Performance Audit) p 26, http://www.anao.gov.au/~/media/Uploads/Audit%20Reports/2010%2011/201011%20Audit%20Report%20No%2052.pdf.
[2] Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (Cth) Sched 1 item 26, 'Guide to Division 50', i.e. Div 50 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997).
[3] Ibid Sched 1 item 44, inserting new definition into s 995-1(1) of the ITAA 1997.

(a) is not carried on for the profit or gain of its owners or members, neither while it is operating nor upon winding up; and
(b) under an *Australian law, *foreign law, or the entity's governing rules, is prohibited from distributing, and does not distribute, its profits or assets to its owners or members (whether in money, property or other benefits), neither while it is operating nor upon winding up, unless the distribution:
    (i) is made to another not-for-profit entity with a similar purpose; or
    (ii) is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.

The requirement in (a), that the organisation 'is not carried on for the profit or gain of its owners or members', properly limits the scope of allowable activities and is in line with the current statutory language. It is the addition of (b) which confuses the matter, and the EM provides little clarity.

The current federal tax provisions

While there are other income tax definitions of 'not for profit', the main ones are:

- *Income Tax Assessment Act 1977* (Cth) s 995–1 in which 'non-profit company' has the meaning given by section 3 of the *Income Tax Act 1986*—

  Income Tax Act 1986

  non-profit company means:
  (a) a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members; or
  (b) a friendly society dispensary.

- *Fringe Benefits Tax Assessment Act 1986* (Cth) s 136 is essentially the same:
  non-profit company means a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members.

This definition is settled and understood. The section was recently considered by the Full Court of the Federal Court in *Commissioner of Taxation v Co-operative Bulk Handling Limited* [2010] FCAFC 155.[4]

The primary judge had determined that Co-operative Bulk Handling (CBH) was entitled to tax exempt status on the basis of its purpose for promoting the development of Australian agricultural resources and because it satisfied the condition that it was 'not carried on for the profit or gain of its individual members' (Income Tax Assessment Act 1997, section 50-40). On appeal, the majority in the Full Court of the Federal Court endorsed the decision of the primary judge and dismissed the Commissioner's appeal. The following outlines the reasons of the majority.

CBH had enjoyed tax exempt status since 1972 when amendments were made to the Bulk Handling Act 1967 (WA) (BHA) which prevented it from distributing income or property directly to its members either during its operations or in its winding up, instead requiring it to apply such income and property towards its objects. One purpose of the amendments had been to ensure that CBH would be exempt from paying tax on surplus income and thereby provide advantage to WA grain growers, most of whom were shareholders, in the form of better service and reduced rates. This benefit to members was one reason the Commissioner argued that CBH no longer fulfilled the special condition of not providing profit or gain to members. CBH had also grown considerably in income (being in the multimillions of

[4] ACPNS casenote at https://wiki.qut.edu.au/download/attachments/65536204/C+of+T+v+Co-operative+Bulk+Handling.pdf?version=1&modificationDate=1296535461000. The full case is available at http://www.austlii.edu.au/au/cases/cth/FCAFC/2010/155.html.

dollars) and scope of operations, with a number of subsidiary companies which paid tax. This case did not concern those subsidiaries.

The two issues arose from the requirements for tax exempt status in ITAA 1997, section 50-40, item 8.2:

1. Whether its objects of receiving, storing and handling wheat and other grain in bulk satisfied the purpose of 'promoting the development of ... Australian ... agricultural resources';
2. Whether it satisfied the condition of being 'not carried on for the profit or gain of its individual members'.

On the second issue, the primary judge had determined that CBH's activities were not carried on for benefit or gain of members because it was restrained by the BHA from applying or distributing its assets to the individual benefit of its members, but had to apply them to further its objects. The Commissioner focused on 'gain' in the second limb of item 8.2, arguing that 'a corporate body is carried on for gain if it makes the profit or gain itself and distributes all or part of the gain to members and also if it successfully operates so that what would otherwise be included in its profits or gains are passed to its members "severally and individually"' (para 87). The majority considered the meaning of the negative requirement of the second limb of item 8.2: 'members may benefit along with others in the community but should not, by virtue of their membership alone, benefit more than others for whom the benefit of the activity is conducted. .... The question arises as to the role played by "individual" in the phrase' (paras 88–9). The majority of the Court considered that a gain or benefit to members would not preclude exemption unless it is a 'gain produced only by reason of individual membership' (para 94). CBH imposed no differential charge for its services according to membership; it provided services to all WA grain growers on the same basis, and the benefit was found to derive 'from the application of revenue or profits of CBH being applied to research, quality control in grading, storage and handling, and through the facilities developed to serve and secure markets for grain growers' (para 94). So 'the incidental gain or benefit achieved as a member does not disentitle exemption for the association because that incidental gain or benefit is not received by reason of membership but is received in conjunction with all grain growers in Western Australia whether members or not' (para 94).

By statute, CBH had to make its facilities available to any producer of grains whether a member or not, and its activities enured for the benefit of the industry as a whole, not solely for members. The Court said 'While members do benefit from the activities of CBH, ..., they do so to no greater extent than, and have no preference over, its non-members who deal with the company, and in these circumstances such benefits do not accrue to them as "individual members"' (para 112).

If it is the intention of parliament to alter this case law, then it should be stated explicitly in the EM.

The additional words in para (b) of the definition

There are a number of problems with the additional words in para (b) which need to be addressed.

The section and EM **do not make clear that receiving 'profit or assets' otherwise than in one's capacity as an 'owner or member' is not prohibited.** There is an exception for distributions to an entity with similar purposes or the reasonable compensation for services or expenses genuinely incurred, however the new provision has the potential to catch owners or members who receive the 'profit or assets'[5] of the organisation other than as a member. For example, it is common for 'users' of a nonprofit organisation's services to be members, or even officers on the organisation's governing body; they receive services and/or money in their capacity as persons who need assistance, in the fulfilment of an organisation's stated purposes. Many government agencies encourage 'user' participation in governance in disability and health related nonprofit enterprises. A HIV prevention organisation may have members or directors who are affected by HIV or AIDS; under this provision, giving assistance to these members could imperil the organisation's tax concession status.

[5] Assets is not defined in the ITAA 1997 (apart from specialist meanings for CGT etc) and so the ordinary meaning would apply: 'An item, whether tangible or intangible, having economic value to its owner which, if not already in the form of money, can be converted into money to the owner's benefit.' See *Re Chetkovich* [1965] ALR 342.

The usual drafting technique to avoid such a situation is adopted in nonprofit associations incorporation legislation. The various state and territory Acts have endeavoured to give a more extensive definition. While unfortunately not uniform, for the most part they are similar.[6]

It is not clear however where one draws the boundary in relation to indirect benefits. The issue was considered in *Commissioner of State Revenue v Bogong Ski Club Inc* [2000] VSC 520.

An example is section 4 of the Queensland *Associations Incorporation Act 1981*.

4 Whether association is formed or carried on for the purpose of financial gain for its members

(1) An association is not formed or carried on for the purpose of financial gain for its members merely because 1 or more of the following circumstances apply to it—

(a) the association makes a financial gain, but no part of the gain is divided among, or received by, any of the association's members;

(b) the association is established to protect or regulate a trade, business, industry or calling (the pursuit) engaged in by its members, or in which they are interested, but the association does not itself engage or take part in the pursuit;

(c) the association provides its members with facilities or services;

(d) the association trades with its members, but the trade is ancillary to its principal purpose;

(e) the association trades with the public, but the trade is ancillary to the association's principal purpose and is not substantial when compared with its other activities;

(f) the association makes a financial gain from—

(i) trading to which paragraph (d) or (e) applies; or

(ii) charging admission fees to displays, exhibitions, contests, sporting fixtures or other occasions conducted to promote its objects; or

(iii) charging subscriptions to further its objects; or

(iv) receiving donations to further its objects;

(g) the members of the association are entitled to divide the property of the association between them on its dissolution;

(h) a member of the association—

(i) receives a salary as an employee or officer of the association; or

(ii) makes a financial gain from the association to which a non-member, acting instead of the member, would equally be entitled; or

(iii) receives a trophy or prize (other than money) from the association because of a competition; or

(iv) receives temporary assistance because of illness, injury or bereavement or other financial hardship suffered by the member.

Editor's note—

An association is not eligible for incorporation if it has a purpose of providing financial gain for its members—see section 5(1)(c) (Eligibility for incorporation).

(2) If a person receives a financial gain from an association because of the membership of the association of someone else (the member), the financial gain is taken to have been received by the member.

(3) In subsection (1)(b)—association includes a branch or part of the association.

The EM to this Tax Laws Amendment Bill has the following references to 'direct and indirect':[7]

> 1.104 A not-for-profit entity is generally an entity with a community or social purpose. It is an entity that is not operating for the profit or gain of its individual members, whether these gains be **direct or indirect**. This applies both while the entity is operating and when the entity winds up.

[6] Associations Incorporation Acts: NSW s 5; SA, s18(5);Tas s 2; Vic ss 3(1), 51(1); 2(2); ACT s 4; NT s4(1); Qld s 4.

[7] Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 Explanatory Memorandum, p 25 [emphasis added].

> 1.105 Additionally, a not-for-profit entity is one that does not provide any private benefit, **directly or indirectly**, to a related party such as a trustee, member, director, employee, agent or officer of a trustee, donor, founder, or to an associate of any of these entities (other than reasonable remuneration for services provided or re-imbursement of related costs).

With respect, this is a long bow to draw from the actual words of the Bill and if this is parliament's intention, it should be included in the actual words of the section. To do otherwise is to confuse and mislead the average reader. In any case, as noted above, this goes too far, as one would never be able to be a member or owner and receive benefits in another capacity from the organisation. The consequences of this are well drawn out in the submission by Neumann and Turnour.

During consultations, some people in the sector and ATO have floated the notion that a nonprofit organisation can 'distribute' profits to its owners.[8] This is a complex matter, but I reject the notion, as a nonprofit cannot distribute a dividend to a member or anyone else. It may gift or transfer property to achieve its stated purposes, but it cannot distribute dividends or a pre-determined share of profits or gain. This was recognised recently by the parliament in its amendments to the *Corporations Act 2001* which prohibits distribution of dividends by Companies Limited by Guarantee.[9] (In my view, this was already the position at common law.)

2. The ACNC RIS was flawed and did not provide adequate policy options:

The Regulation Impact Statement (RIS) prepared for government failed to present to policy makers the option of locating the ACNC within ASIC, as was proposed by the Productivity Commission. The reasons for this omission should be disclosed. Locating the ACNC within ASIC would be in line with the Productivity Commission recommendation:[10]

> While ultimately the Registrar could be an independent statutory body, initially it should be established as a statutory body corporate or organ in the Australian Securities and Investment Commission.[11]

The option has a number of advantages over the present proposal including:

- a greater alignment with the activity of the ACNC as an 'entity' and a 'consumer oriented' regulator with accompanying 'culture';
- actual and perceived independence from tax authorities;
- no need to re-locate corporate law provisions into a separate Act;
- greater experience in cross-jurisdictional operation and state co-operation;
- existing infrastructure for on-going state co-operation and consultation;
- closer fit with information technology for delivering public documents;
- more talent and experience in dealing with general financial statements;
- greater geographic public accessibility across Australia; and
- education dissemination outlets.

Why was this option not canvassed at all in the RIS?

On 21 January 2011, Assistant Treasurer Bill Shorten and Minister for Social Inclusion Tanya Plibersek released a consultation paper, *Scoping Study for a National Not-for-profit Regulator*, as part of public consultation on the design of a new national regulator for the nonprofit sector.[12] Submissions closed on 25 February, 2011 and most debate surrounded the options to set up a national regulator as an independent body, or as part of the ATO or ASIC. The

[8] Refer to cases such as *Brighton College v Marriott* [1926] AC 192; *IRC v Mullen* [1978] 1WLR 664.
[9] *Corporations Act 2001* (Cth) s 254SA.
[10] Productivity Commission (2010) *Contribution of the Not-for-Profit Sector: Research Report*, Recommendation 6.5.
[11] Ibid, p XLIII.
[12] The Treasury (2011), *Scoping Study for a National Not-for-profit Regulator: Consultation Paper,* http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1934

Final Report: Scoping Study for a National Not-for-profit Regulator[13] was released in April 2011. Its recommendations in relation to the form of a national regulator were:

> 40. The Commonwealth should pursue the long term objective of a single national regulator and regulation for the NFP sector, noting that the Commonwealth does not have the constitutional power to implement this alone.
> 41. The Australian Government should seek agreement with the states and territories on a single national regulator through COAG.
> 42. As setting up a national regulator will take time, the Government should improve Commonwealth regulation for the sector in the interim, ensuring that regulatory overlap at a Commonwealth level is removed.[14]

The Australian Charities and Not-for-profits Commission Regulation Impact Statement[15] was prepared for government as part of the process for deciding to establish a national regulator, but it has been an unheralded document (and at the time of writing, still does not appear on the Treasury's Not-for-profit Reform web site[16]).

The accepted protocol is that 'A RIS is mandatory for all decisions made by the Australian Government and its agencies that are likely to have a regulatory impact on business or the not-for-profit sector, unless that impact is of a minor or machinery nature and does not substantially alter existing arrangements.'[17] The primary role of the RIS is to improve government decision making processes by **ensuring that all relevant information is presented** to the decision maker when a policy decision is being made.[18]

The RIS summarised the 'problem' as:[19]

> The NFP sector's regulatory framework is not meeting the needs of the NFP sector, Australian governments and the Australian public more broadly. The regulatory framework under which NFP entities operate is:
> - fragmented and inconsistent;
> - uncoordinated with regulatory responsibilities spread across a range of government agencies;
> - producing complex reporting requirements which are, in certain situations, overlapping; and
> - not adequately addressing the informational needs of the Australian public.

The RIS proposed five options to remedy this problem:[20]

> 1. Retain the existing policy;
> 2. Pursue the establishment of a national regulatory framework;
> 3. Establish the Australian NFP Administrator within the ATO;
> 4. Establish an independent statutory office regulator called the Australian Charities and NFP Commission;
> 5. Establish an independent Financial Management and Accountability Act regulator called the Australian Charities and NFP Commission.

It is notable that the option to establish the ACNC as an independent body within ASIC was not mentioned at all in the RIS, despite its having been considered in detail in previous consultations and reports. There is no explanation in

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[13] The Treasury (2011) *Final Report: Scoping Study for a National Not-for-profit Regulator*, http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=2054.
[14] Ibid, p 68.
[15] The Treasury (2011) *Regulation Impact Statement: Establishing a Regulator for the Not-for-profit Sector*, http://ris.finance.gov.au/2011/05/19/establishment-of-the-australian-charities-and-not-for-profits-commission-regulation-impact-statement-%e2%80%93treasury/.
[16] http://www.treasury.gov.au/Policy-Topics/PeopleAndSociety/NFP-reform.
[17] Department of Finance and Deregulation, 'Australian Government RIS Requirements: Summary of the Requirements', http://www.finance.gov.au/obpr/proposal/gov-requirements.html#handbook.
[18] Ibid [emphasis added].
[19] The Treasury (2011) *Regulation Impact Statement: Establishing a Regulator for the Not-for-profit Sector*, p 1–2.
[20] Ibid p 11.

the RIS for this omission. I believe Australians will come to regret this failure to consider the ASIC option properly. It is a world class regulator.

3. Governance standards need to be included in this consultation process

The Centre made an extensive and detailed submission about the issue of nonprofit governance, in response to the Treasury's public consultation on its governance discussion paper.[21] Our sense is that, due to the Treasury's approach to public consultation, many in the sector are uncomfortable about having such an important issue left to further Treasury consultation and regulation. The observations made by Treasury itself about its consultation process support this conclusion.[22] It states in part:

> Some stakeholders felt that building relationships with Treasury can be difficult because officers can be reticent to volunteer information which can of itself reduce the quality of engagement. Staff expressed the view that Treasury officers can be reluctant to consider the views of others, particularly in areas considered to be within the department's areas of expertise, which can be perceived as obstructive and is detrimental to fostering good stakeholder relationships. More generally, a widely perceived characteristic of Treasury is that it sometimes 'does not know what it doesn't know', and a better identification of knowledge gaps, and a targeted approach to seeking out expertise, would improve policy outcomes. All this suggests there is much to be gained from focu[s]ed training on engagement and consultation techniques and skills.[23]

This is mild and cautious, when compared to what we are hearing from the sector. It is not a reflection on the Treasury officers, but a comment upon the systems and processes in which they found themselves. It was all the more apparent when put against the excellent and well-received consultation process developed and executed by the Interim ACNC Taskforce.

Further, we point out that much of the value of 'governance principles' is that those members of the public who are to be affected, and their peak representative bodies, should be closely engaged with developing the principles so they feel a sense of ownership and responsibility for them (e.g. development of the ASX codes). This may not happen if current Treasury processes are followed.

4. Plain language drafting – 'responsible entity' and 'registered entity'

Commonwealth legislative drafters have produced some excellent plain English statutes. Given the complexity of issues involved, the GST legislation and the *Corporations Act* (particularly the plain English guide for small scale enterprises) are excellent pieces of drafting. The same standard should be reached in these instruments, given that they will affect and will need to be used by ordinary citizens who volunteer their time for the public good. Terms such as 'responsible entity' and 'registered entity' are likely to confuse and confound many ordinary people, and make the task of ACNC staff all the more difficult, time-consuming and costly.

Yours faithfully

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[21] The Treasury (2011) *Review of Not-for-=profit Governance Arrangements: Consultation Paper*, http://archive.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2252.
[22] The Treasury (2011) *Strategic Review of the Treasury*, p 19 ff.
[23] Ibid, p 21.