

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

INQUIRY INTO THE AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION EXPOSURE DRAFT BILLS

NSW GOVERNMENT SUBMISSION

EXECUTIVE SUMMARY

Note

- 1.1 Given the short timeframe stipulated for providing submissions to the Committee, the NSW submission has been limited to key issues only and should not be read as a comprehensive assessment of the *Australian Charities and Not-for-profits Commission (ACNC) Exposure Draft Bill* (herein referred to as the Bill).

2 Background

- 2.1 State governments have considerable experience regulating fundraising, charitable trusts, incorporated associations and cooperatives, and in managing state taxes and exemptions.
- 2.2 NSW recognises the significant economic, social, cultural and environmental benefits delivered through and by not-for-profit (NFP) entities, identified by the Productivity Commission in its 2010 Research Report, *Contribution of the Not-for-profit Sector*.
- 2.3 Australia's NFP sector is large & extremely diverse, with about 600,000 entities in total. Of these, around 60,000 are charities and about 5,000 of these charities are constituted as companies limited by guarantee and regulated by the Commonwealth Government. Trustee corporations are also regulated by the Commonwealth Government.
- 2.4 Across Australia there are also approximately 136,000 NFP incorporated associations registered with, and regulated by, states and territories (herein collectively referred to as the states) and about 440,000 small unincorporated NFPs.
- 2.5 In NSW, there are approximately 35,500 incorporated associations currently registered and around 400 non-distributing co-operatives, many of which are NFPs. Of the incorporated associations, approximately 4,000 are also a charity.
- 2.6 The Commonwealth Government announced a range of measures as part of the 2011-12 Budget to streamline administrative processes and introduce a new regulatory framework for the NFP sector at the Commonwealth level. These measures included:
 - 2.6.1 changes to the way Commonwealth tax concessions are determined in respect of the unrelated commercial activities of NFP entities;
 - 2.6.2 the establishment of the ACNC by 1 July 2012 (since delayed to 1 October) to provide a registration process used by various Commonwealth agencies for regulatory and administrative processes. It would also introduce a regime operated by the ACNC to regulate the activities of NFPs through governance and reporting requirements and penalty and enforcement regimes; and

2.6.3 the introduction of a statutory definition of charity for all Commonwealth laws from 1 July 2013.

2.7 The Commonwealth Government has committed to consultation with state governments about national regulation, a new national regulator for the NFP sector, general reporting and a public information portal. To this end, the NSW Government has made submissions to various public consultation papers released by the Commonwealth Government. NSW will be carefully considering the impacts of any changes proposed by the Commonwealth, in order to influence the reforms with a view to producing better outcomes for NSW NFP entities and the broader community.

3 Regulation principles

3.1 The NSW Government is committed to reducing the regulatory burden on the NFP sector to allow organisations to focus resources on the important services they deliver.

3.2 Regulation imposes significant costs on individuals, businesses, government and the economy. Governments should only look to regulate markets where there is a clearly identified failure, and they should implement solutions that provide the most effective response with minimum government intervention.

3.3 Introducing new regulations, or amending existing regulation, should be done in response to clearly identified problems or failures in the market, and after a comprehensive analysis of the costs and benefits of different solutions that specifically target the problem. The costs and benefits of self-regulation, co-regulation and non-regulatory approaches should always be assessed in conjunction with a regulatory approach, as regulation is not always the lowest cost or most effective approach for business and the community.

3.4 Undertaking a Regulatory Impact Statement (RIS) that complies with best practice principles is an effective way to determine the most efficient and effective solution that will generate the greatest net benefit for the community. All Australian governments, through the Council of Australian Governments (COAG), agreed that a RIS must be prepared for all regulatory proposals which would affect business or impact upon competition (the RIS for Standing Council proposals must comply with the *COAG Best Practice Regulation Guide*).

3.5 It is noted that the Bill is not supported by a RIS that meets the COAG guidelines for “an adequate analysis of the costs and benefits of the feasible options”¹. Without this analysis, it is not clear whether the Bill enacts a reasonable, proportional and risk-based regulatory framework that supports the NFP sector, encourages community engagement and fosters confidence in the sector.

3.6 The Commonwealth’s current approach, as outlined in the Bill, may not be the most efficient and effective option for all NFPs. NSW considers further consultation and discussion would better inform the most appropriate regulatory regime, particularly for those entities regulated by the states.

¹ *COAG Best Practice Regulation Guide for Ministerial Councils and National Standard Setting Bodies*, October 2007, p11.

4 NSW recommendation

- 4.1 The NFP sector has a sound reputation for responsible governance and management and should not be exposed to an unnecessarily burdensome or complex regulatory regime. This is especially important for charities and NFPs which have no, or limited, capacity to allocate resources for non-core activities in this sector. As such, NSW supports a light-touch approach to regulation that balances the need for transparency and accountability with simplicity and efficiency.
- 4.2 The Commonwealth does not have the constitutional power to legislate for NFP regulation exhaustively or comprehensively. The Bill expressly allows for the continued operation of concurrent state and territory law. Hence, the establishment of the ACNC will not obviate the State's need to retain its current regulatory powers over NFPs that fall, or may later fall, outside the reach of the ACNC and to determine eligibility for NSW tax concessions.
- 4.3 The reach of the Bill is also very broad, and proposes to include entities that are not currently directly regulated by the Commonwealth under the *Corporations Act 2001* (Cth). For example, any entity that wishes to access Commonwealth concessions, exemptions or benefits will need to register with, and be regulated by, the ACNC.
- 4.4 This will mean that the Bill will create another layer of regulation and compliance burden for a range of charities who will continue to be regulated under NSW legislation and are accountable to the State and/or their stakeholders. The Bill will also capture a number of NFPs who are currently operating free from formal government oversight, with no evidence provided that there is systemic fraud or misleading conduct that needs to be redressed by government regulation.
- 4.5 The extension of the Bill to NFPs currently regulated under state law also poses serious issues with respect to enforcement powers. For example, a registered entity that is not a federally regulated entity may not receive the same opportunities to comply with the Bill before registration is revoked (which could result in the loss of significant tax concessions and grants). Differential application of the power to revoke registration offends the principle of regulatory proportionality.
- 4.6 **Given these critical issues, the Committee may wish to consider the merit of constraining the Bill's application only to those corporations, or matters relating to corporations, to which the *Corporations Act 2001* (Cth) applies. Importantly, this would exclude public sector bodies which are already extensively regulated.**
- 4.7 This would mean that the Bill would only apply in the first instance to charities the Commonwealth currently directly regulates. Alternatively, the Bill could exclude those entities already regulated under state law, such as incorporated associations, cooperatives and public sector bodies.
- 4.8 These options would allow time for all jurisdictions to work together to minimise red tape and avoid legal and operational perversities arising from the Bill, before an additional layer of regulation is imposed on some charities operating in, and/or regulated by, the states. Once these issues have been resolved between jurisdictions, the Bill could then be amended to reflect the outcome.

5 COAG Not-for-profit Working Group

- 5.1 The NSW government is actively participating in intergovernmental discussions through a COAG Working Group to consider options for harmonising the regulatory arrangements for fundraising and the NFP sector operating across Australia. The objective of this work is to avoid or minimise any regulatory duplication arising from the operation of both the ACNC and state regulators, particularly that arising from duplicative reporting and governance requirements.
- 5.2 NSW believes that there are significant risks in progressing the Bill in its current form before the COAG Working Group's analysis is finalised towards the end of 2012.
- 5.3 NSW considers it critical that all jurisdictions have a role in determining the regulatory requirements to ensure that unnecessary regulatory duplication does not arise as a result of the establishment of the ACNC. This includes through duplication arising from the Bill and associated regulations. The detail of the reporting and governance requirements has been extracted from an earlier version of the Bill, with the intention that they be later passed in regulations for commencement in July 2013. However, the Bill still establishes the framework for these responsibilities and, in the case of reporting, sets out specific requirements.
- 5.4 The Working Group is looking at options to achieve more regulatory harmonisation, and will complete a comprehensive analysis of the costs and benefits of all options available to streamline arrangements across jurisdictions to reduce NFP red tape.
- 5.5 Without pre-empting the outcomes of this analysis, it is possible that, at least in some circumstances, the existing state and territory regulations present the lowest cost and most efficient regulatory regime.
- 5.6 The Productivity Commission research report on the *Contribution of the Not-for-profit Sector* concluded that "States and territories remain well placed to regulate smaller and state based NFPs. Many have been moving to reduce compliance burdens. These could be further reduced by harmonisation of legal and reporting obligations, including fundraising."²

² Productivity Commission - 2010 Research Report - *Contribution of the Not-for-profit Sector* (p113)

KEY ISSUES

6 Two regulatory regimes and additional costs to the NFP sector

- 6.1 Under the Bill, state laws that are capable of operating concurrently are not intended to be excluded or limited.
- 6.2 The Commonwealth currently directly regulates NFP corporations constituted under or by the Commonwealth legislation. The reach of the ACNC Bill, however, will extend beyond these entities. It will apply a mandatory regulatory regime and compulsory enforcement regime to all “federally regulated entities”, which include charities which are trading or financial corporations constituted under state and territory law.
- 6.2.1 To determine if an entity is a trading or financial corporation as per s51(xx) of the *Constitution*, an assessment must be made as to whether the entity engages in significant trading activities³. This assessment is potentially complex and may require entities to seek professional legal advice. This may be out of the reach of many small organisations.
- 6.3 The Bill will also apply a voluntary regulatory regime to non-federally regulated entities. However, if these entities wish to receive any Commonwealth concessions, exemptions and other benefits (for example, grants, various tax concessions and exemptions from the Do Not Call Register) that will have to register with, and be regulated by, the ACNC. These entities could include both incorporated and unincorporated associations that are currently regulated under state and/or common law.
- 6.4 This means that to keep current Commonwealth government benefits a large number of NSW incorporated associations and some cooperatives will be subject to two regulatory regimes in relation to registration, lodgement of annual information and supervisory and investigative oversight.
- 6.5 Many NFPs will continue to need to register with the states to gain incorporated status. Under the draft Bill incorporated associations and cooperatives in NSW will have to register with the ACNC, in addition to their registration in NSW, in order to: maintain their DGR status; continue to access other tax concessions; and avoid the risk of loss of benefits.
- 6.6 These entities may find themselves subject to additional reporting obligations, monitoring and enforcement action. There will be another two or more levels of compliance obligation imposed on the sector that will potentially divert NFP money from its intended purpose.
- 6.7 Many NFPs have minimal administrative staff or are completely volunteer run. Even small additional requirements could have a detrimental impact on the delivery of an organisation’s programs. There is a risk that the regulation requirement may force the large number of small and unincorporated NFPs to participate in a scheme that is of no benefit to them.
- 6.7.1 The Productivity Commission excluded small unincorporated entities and organisations that rely solely on member contributions (such as cooperatives) from their analysis of the efficiency and effectiveness of NFP organisations.

³ See *The Queen v Federal Court of Australia; ex parte Western Australian National Football League* [1979] 143 CLR 190

This was because 'these organisations have strong governance relationships with their members that are largely independent of the regulatory environment, an assumption supported by the lack of issues raised in submissions in relation to the efficiency and effectiveness of these organisations'.⁴

- 6.8 Importantly, all Governments, through COAG, have undertaken to ensure regulatory processes in their jurisdiction are consistent with agreed best practice principles that will ensure regulation is only applied where necessary to address an identified problem and generates the greatest net benefit for the community.
- 6.9 Both the NSW and Victorian governments have recently reviewed their regulatory requirements for incorporated associations in close consultation with the NFP sector, adopting a risk management approach. In addition, on 18 May 2012 the *Co-operatives (Adoption of National Law) Act 2012* (NSW) received assent. NSW is the lead jurisdiction and other states and territories will introduce consistent laws. This legislation removes existing barriers to interstate business activities and ensures cooperation and consistency between jurisdictions.
- 6.10 It will be important that any reforms at the Commonwealth level do not undermine the red tape reductions achieved by these recent legislative changes. The NSW Government considers that there remains potential to streamline regulatory requirements for NFPs if there is genuine collaboration between the Commonwealth and all states.
- 6.11 A significant proportion of incorporated associations operate within a confined geographical area and do not seek to operate across jurisdictions. For these entities, the current regulatory regime is appropriate.
- 6.12 The Bill also exempts basic religious charities. An entity cannot be a basic religious charity if it is incorporated under the *Associations Incorporation Act 2009* (NSW). NSW has a number of incorporated associations that could otherwise be considered as a religious charity. If registered with the ACNC, these entities will be subject to two sets of reporting standards, unlike other religious charities that are unincorporated.
- 6.13 In particular, NSW notes that the governance principles are still under consideration and will be introduced via regulations for commencement on 1 July 2013. Given the importance of these principles for the ACNC's operation and the potential for additional regulatory burden for NFPs, we understand that the Commonwealth intends to release a RIS discussing options to determine the relative merits of different regulatory approaches.
- 6.14 NSW recommends that this RIS complies with the COAG best practice principles and takes into account existing state regulatory environments.
- 6.15 This will ensure that a full assessment of the cost and benefits of the governance options is undertaken for all affected stakeholders. A compliant RIS is critical to ensuring the delivery of an effective and proportionate regulatory environment, which places the minimum level of compliance burden on the sector.

⁴ Productivity Commission - 2010 Research Report - *Contribution of the Not-for-profit Sector* (p8-9)

7 Constitutional limits and legal issues

- 7.1 The Commonwealth does not have the constitutional power to regulate the NFP sector on a comprehensive basis.
- 7.2 The concurrent operation of state laws also requires clarification given that the Bill may create inconsistency with some state acts (within the meaning of section 109 of the Constitution). For example, a potential inconsistency with the *Associations Incorporation Act 2009* (NSW) could arise in the exercise of enforcement and other compulsive powers of the Bill. There are also important potential inconsistencies with the *Charitable Trusts Act 1993* (NSW) and the *Charitable Fundraising Act 1991* (NSW).
- 7.3 It is also important that the Bill does not override important national reforms including the National Regulatory System for Community Housing Providers (NRS) and the Co-operatives National Law Reform.
- 7.4 For example, it is envisaged that the NFP sector will play a key role in addressing housing affordability and homelessness issues in Australia through the NRS. Therefore, the Commonwealth needs to consider the potential overlap in administration (in particular reporting and governance requirements) between NRS and the regime to be administered by the ACNC.
- 7.5 It is difficult to assess the reach of the Bill without the consequential amendments arising from the Bill. Registration is a precondition for access to Commonwealth tax concessions and 'other' concessions, exemptions and benefits. The consequential amendments are required to confirm what 'other' concessions, exemptions and benefits the Commonwealth intends to make a pre-condition for registration.

8 Enforcement powers

- 8.1 The enforcement powers conferred on the ACNC are extremely broad, covering warnings, directions, enforceable undertakings, injunctions as well as suspension or removal of responsible entities. These powers may only be applied in relation to federally regulated entities. However, the ACNC will also have the power to revoke the registration of an entity if it does not comply with a governance or external conduct standard, whether the entity is a federally regulated entity or not.
- 8.2 While the explanatory materials state that the ACNC will aim to use education and guidance to assist such entities to understand and comply with their obligations under the Bill, this nevertheless creates a two-tiered enforcement regime. For example, a federally regulated entity that has not complied with a governance standard may receive a graduated and proportionate system of warnings and directions before registration is revoked, whereas a registered entity that is not a federally regulated entity may have their registration revoked without receiving the same opportunities to comply.
- 8.3 Revocation of registration is a significant penalty that could result in the loss of significant tax concessions and grants. Differential application of the power to revoke registration where registered entities are not federally regulated offends the principle of regulatory proportionality.
- 8.4 This may also give rise to the situation whereby it is the members and beneficiaries of a NFP organisation who suffer the, perhaps substantial, consequences of the actions of office holders.

9 Suspension and removal of responsible entities

- 9.1 The Bill gives the Commissioner the power to remove or suspend responsible entities and to appoint acting responsible entities. The Commissioner can only exercise this power in relation to federally regulated entities, which include constitutional corporations, or trusts, all of the trustees of which are constitutional corporations.
- 9.2 Despite the limitations placed on the Commissioner, these enforcement provisions will nevertheless overlap with existing state laws and common law regarding trusts. The Supreme Court of NSW (like the Supreme Courts of other states) has a well-established jurisdiction in the supervision of trusts and trustees, including charitable trusts. That jurisdiction includes the removal and replacement of trustees and the settling of *cy-pres* schemes where the purpose of a charitable trust cannot be achieved.
- 9.3 The explanatory materials state that the Commissioner has been given the power to suspend and remove trustees to ensure that the Commissioner can deliver ‘a proportionate, balanced and effective regulatory response.’ However, removing a trustee is a serious matter. The courts deal with such applications in full hearings and with all due procedural fairness. It is not desirable that such a serious result should be achieved through administrative processes.
- 9.4 It is also undesirable to create a regime whereby corporate trustees are dealt with under a separate jurisdiction to individual trustees. The same rules should apply in respect of corporate trustees as apply in respect of individuals.
- 9.5 The Bill states that it is not intended to exclude or limit the operation of a law of a state that is capable of operating concurrently. However, where the ACNC Commissioner and the Courts have concurrent jurisdiction to remove and appoint trustees there is a risk that inconsistencies may arise. For example, if the Supreme Court declines to exercise its inherent jurisdiction to remove a trustee and the Commissioner then removes the trustee on the same facts, the Commissioner would in effect be overriding the Supreme Court’s decision (or vice versa).
- 9.6 Providing an alternative means to seek removal of a trustee could also encourage ‘forum-shopping’. For example, aggrieved beneficiaries could seek the avenue perceived to be most advantageous to them. While the Bill provides a mechanism to appeal a decision to suspend or remove a trustee to the Supreme Court, there is no statement regarding what should occur where a matter is the subject of court proceedings and is simultaneously being dealt with by the Commissioner.
- 9.7 It is also of concern that the Commissioner’s enforcement powers can be exercised not only where governance standards and other requirements have been contravened, but also where they are ‘likely to be’ contravened. The combination of the high level of detail regarding legal obligations and the discretionary nature of the Commissioner’s powers is likely to restrict the circumstances in which a party may successfully apply for review.

10 Revoking registration

- 10.1 If a registered entity requests revocation of its registration, the Commissioner has discretion as to whether to accede to the request (i.e. “may revoke”). As registration is voluntary, it is at odds that the entity does not have the automatic right to surrender their registration, unless there is a demonstrated case to not do so.

10.2 A lack of constitutional clarity around deregistration could give rise to unproductive and expensive litigation.

11 Exemption of public sector bodies

11.1 The NSW Government recognises the need to apply high standards of transparency and accountability in respect of bodies established under NSW statutes. There are substantial differences between public sector entities and those in the private sector. Public sector bodies are publicly accountable for their administrative effectiveness, efficiency and performance. They are controlled by legislative and other arrangements under state law and are subject to substantial financial management and audit controls imposed by the states.

11.2 These controls are extensive and subject these entities to a significant level of prudential control, and public and government scrutiny. NSW considers it would be inappropriate and unnecessary for such entities to be subject to additional regulation by the Commonwealth.

12 Objects of this Act

12.1 The Commonwealth has signalled its intention that the role of the ACNC will expand to include responsibility for the regulation of all NFPs in Australia. The Bill has been drafted to reflect an expansive regulatory role for the ACNC, consistent with this longer term view. NSW is concerned this approach could pre-empt the outcome of future consultations with governments and the sector.

12.2 The Preamble describes the NFP sector as being "funded by donations from members of the public and by tax concessions, grants and other support from Australian governments". While this is correct for some of the NFP sector, a significant proportion is also comprised of entities that could be described as self-funded interest groups who are not in receipt of tax concessions, public donations or government grant funding. It is likely they would not pay income tax due to the normal operation of tax provisions.

12.3 These entities may face the prospect of future regulation by the ACNC under legislation with an objective "to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector". Such an object is not appropriate for these entities as they have no 'public persona'. They are essentially member-based organisations with accountability and obligations to their members.

13 The ACNC register

13.1 Philanthropic trusts and Private Ancillary Funds in particular have expressed resistance at having names of each responsible entity included on the public register. This is particularly relevant when high-wealth individuals prefer anonymity. Whilst the Commissioner has the discretion to remove information from the register, the Commissioner must consider whether the inclusion of a name has the potential to cause detriment to an individual. This process requires clarification. It is recommended that the Commissioner be required to make such a determination before an entity applies for registration with the ACNC.