

Briefing on various reforms to the charities and not-for-profit sector

(A briefing provided to parishes, organisations and schools of the Anglican Church in the Diocese of Sydney.)

Purpose of this briefing

1. The purpose of this briefing is to inform parishes, organisations and schools of the Anglican Church Diocese of Sydney about a number of significant reforms that the Federal Government has or intends to make to the charities and not-for-profit (NFP) sector and the action that has been taken by the Standing Committee of Synod on behalf of the Diocese in response to these reforms.
2. The reforms represent a substantial change to the regulatory landscape of the sector, although the impact of individual reforms may vary between parishes, organisations and schools of the Diocese.
3. The Standing Committee intends having an on-going engagement with Treasury, Government and others in the sector about the reforms. Accordingly your views about the reforms generally and the matters raised in this paper in particular would be welcome and should be directed to the Diocesan Secretary, Mr Robert Wicks at rjw@sydney.anglican.asn.au.

Background

4. Over the past few years there has been increasing momentum to reform the Charities and Not-For-Profit (NFP) sector. Some of the major Government and Parliamentary inquiries which have contributed to this momentum are –
 - Inquiry into the Definition of Charities and Related Organisations (2001)
 - Inquiry into the disclosure regime for Charities and NFP organisations (Senate Standing Committee on Economics) (2008)
 - Australia's Future Tax System (the Henry tax review) (2008)
 - Study into the contribution of the NFP sector (Productivity Commission) (2009)
 - Inquiry into the Tax Laws Amendment (Public Benefit Test) Bill 2010 (Senate Standing Committee on Economics) (2010)
5. More recently, the Federal Government announced its intention to pursue a number of significant reforms to the sector. These include –
 - (a) introducing a tax on the unrelated business income of charities (UBIT)
 - (b) changing the "In Australia" test to tighten the requirements for charities obtaining and retaining tax exempt and deductible gift recipient status
 - (c) replacing the existing common law meaning of charity with a statutory definition of charity
 - (d) establishing a new national regulator for the sector, the Australian Charities and Not-For-Profit Commission (ACNC)
 - (e) introducing a governance framework for NFP entities
 - (f) changing the trusteeship and other requirements for public ancillary funds
 - (g) proposing charitable fund raising reform
 - (h) establishing a NFP Sector Tax Concession Working Group to review the tax concessions currently extended to the NFP sector

During this period, the ATO also issued draft Taxation Rulings on –

- (i) the meaning of "charity" - pending any statutory definition of charity coming into effect (the ruling was finalised in October 2011), and
- (j) the meaning of "school" for the purposes of DGR School Building Funds (final ruling pending)

6. To date, written submissions have been made on behalf of the Diocese by the Standing Committee in relation to each of the matters in 5(a) – (f) and (i) and by the Sydney Property Trust in relation to the matter in 5(j). The Standing Committee is in the process of preparing (or intends making) submissions in relation to the matters in 5(g) and (h).
7. Copies of the Standing Committee's submissions can be obtained from www.sds.asn.au under "For Synod and Standing Committee" then "Reports and Resources".
8. In addition to written submissions, the Standing Committee has been involved in extensive discussions with officials from Treasury and Government as well as others in the sector about the reforms. These discussions are on-going.

Impact of reforms

9. Individually, most of these reforms represent a substantial change to the regulatory landscape of the sector in their own right. Taken together, they represent the most radical shake-up of the sector since Federation. The impact of these reforms on churches and church organisations should not be underestimated.
10. Despite initial assurances from the Government that the primary purpose of these reforms is to "reduce red-tape" and simplify the regulatory environment in which charities and NFP entities operate, to date the reforms have largely gone in the other direction – driven it seems by more recent appeals to the need to maintain public trust and confidence in the sector through greater transparency and accountability etc. This is despite the generally held view that public trust and confidence is not a significant problem in the Australian NFP sector.
11. We therefore appear to be heading toward over-regulation of the sector where the costs associated with complying with the requirements of the new environment are likely to significantly outweigh any apparent benefit either for the sector itself or the public which supports and is served by the sector. There is a risk that such over-regulation will "suffocate" some parts of the sector. This is particularly the case for smaller charities, such as churches, who are unlikely to benefit from the upsides the Government is seeking to achieve by the reforms. These upsides include the "report once use often" aspiration to stream-line Government funding arrangements for charities and the standardisation of charitable fund raising requirements across Australia to assist, in particular, those charities who undertake fundraising in more than one State or Territory.
12. Aside from increased compliance costs, there is also concern, particularly among some welfare agencies that a focus on transparency without a parallel focus on educating the public about the costs associated with delivering welfare services will give rise to "charity league tables". Clearly the sector does not oppose transparency per se. However there has been little indication that the Government has considered the potential down-side to increased transparency for the sector, particularly in the short term.
13. Some of the reforms surrounding the governance arrangements for the NFP sector may also have an impact on volunteering in the sector and, in particular, the willingness of volunteers to serve on NFP boards and committees. The issue here is to get the balance right between ensuring such volunteers exercise an appropriate degree of care and skill in the performance of their duties while at the same time not discouraging persons to serve in this way because of unduly onerous governance obligations and penalties for non-compliance. At this stage, it is not clear that the Government has got this balance right.
14. Brief comments about the status of each of the reforms follow.

Unrelated business income tax

15. In May 2011, the Treasury issued a Consultation Paper entitled "Better targeting of Not-For-Profit tax concessions". The Consultation Paper proposed the removal of tax concession status in respect of income generated from unrelated business activities of charities and other not-for-profit entities which is retained in the business and not directed towards their "altruistic purposes". The proposed changes also extend to the removal of FBT and GST concessions and DGR support from such unrelated business activities whether or not income from such activities is directed to the "altruistic purposes" of the charity.

16. It is proposed that the removal of tax concession status will apply retrospectively to any new unrelated business activities commenced after the reform was announced on 10 May 2011. While the retrospectivity is designed to avoid charities launching unrelated business activities to take advantage of a tax-free window that might otherwise be open to them, the length of time between the announcement and the implementation of the reforms and the uncertainty as to what will be treated as unrelated business activity is creating a considerable degree of uncertainty for some charities in terms of planning and budgeting.
17. The Standing Committee made a submission in response to the Consultation Paper in July 2011. The principal concern expressed in the submission was that, as proposed, the costs to Government and the sector in imposing, complying with, and regulating this reform will outweigh the benefits of the reform. It was submitted that any removal of the tax concessions provided to charities for business activity must be considered in the context of the broader reform process and, in particular, after the new charities regulator has been established and given an opportunity to source appropriate data to correctly characterise and quantify the extent of the potential abuses that the reform seeks to address and after any statutory definition of charity has been put in place.
18. It is understood that similar submissions were made by a significant number of other charitable and not-for-profit bodies.
19. To date there has been little indication as to the approach the Government intends to take in this matter in response to the concerns expressed by the sector. However at a presentation given at the Australian Charity Law Association Annual Conference in September 2011, the Assistant Treasurer conceded that the problem Treasury is seeking to address may be “more of a mouse than a monster” and that he is looking for a pragmatic solution to deal with the problem.
20. The exposure draft of legislation has not yet been released for public comment. However Treasury may want to give “unrelated business activity” a broad meaning and, possibly, seek to extend what will be treated as unrelated (and therefore subject to tax) beyond business activities.
21. This is a matter to watch very closely.

In Australia test

22. In July 2011, the Treasury issued an exposure draft of legislation to give effect to changes to the “in Australia” requirements for entities to obtain and retain income tax exempt and gift deductible status. In short, the exposure draft proposed a significant tightening of the rules for these purposes.
23. In its submission made in August 2011, the Standing Committee expressed support for the policy considerations which underlay the proposal but expressed concern that the proposed means for achieving these policy outcomes (ie through tax law) are not appropriate and will result in bona fide Australian organisations losing their income tax exempt and deductible gift recipient status. In particular, deep concern was expressed about the possibility of Australian resident overseas mission organisations such as CMS losing their income tax exempt status.
24. Again, it is understood that similar submissions were made by other charitable and NFP organisations.
25. In response, the Government took the unusual step of acknowledging that there are many unworkable elements in the initial form of exposure draft. The initial form of exposure draft was therefore withdrawn and is currently being redrafted to address the concerns raised by the sector.
26. The further exposure draft has not yet been released for public comment, although it is expected shortly.

Statutory definition of charity

27. In October 2011, the Treasury issued a Consultation Paper entitled “A Definition of Charity”. The purpose of the Consultation Paper was to seek public comment about replacing the current 400 year old common law meaning of charity with a statutory definition of charity. The reason given for pursuing a statutory definition of charity was to provide certainty and consistency on the meaning of charity in an area of law which can often be confusing and unclear. It is expected that any statutory definition of charity will be finalised by the end of 2012 although will come into effect on 1 July 2013.

28. In its submission made in December 2011, the Standing Committee noted the genuine anxiety within the sector over any proposal to replace the common law meaning of charity with a statutory definition. In particular the submission strongly supported the retention of the “public benefit presumption” which currently applies to charities for the relief of poverty, the advancement of education and the advancement of religion. It was suggested that any removal of the public benefit presumption would give rise to a significant and unjustifiable administrative burden on the sector and would also sit at odds with Australia’s international human rights obligations concerning religious freedom.
29. The Exposure Draft for a statutory definition of charity has not yet been released for public comment.

Australian Charities and Not-For-Profit Commission

30. In December 2011, the Treasury issued an Exposure Draft for the Australian Charities and Not-For-Profit Commission Bill 2012. The primary purpose of the bill was to establish a framework for regulating the not-for-profit and charity sector, including the establishment of the Australian Charities and Not-For-Profit Commission (ACNC) as a new regulator for the sector.
31. The Standing Committee made a submission in response to the Exposure Draft in January 2012. The submission expressed concern about the proposed object of the bill, namely to promote public trust and confidence in the NFP sector, particularly in view of the fact that public trust and confidence had not been identified previously as a significant reason for establishing the new regulatory framework. It was felt that the extensive, and in places, draconian powers proposed to be given to the ACNC have been driven, at least in part, by reference to the more recent appeals for the need to enhance public trust and confidence.
32. The Standing Committee also expressed concern with the proposal that all charities registered with the ACNC with an annual revenue between \$250,000 and \$1 million be required to submit to the ACNC each year audited or reviewed reports prepared in accordance with Australian accounting standards. Charities with an annual revenue in excess of \$1 million must have such reports audited. Presently we are clarifying the impact that these requirements may have on the existing financial reporting obligations of parishes and diocesan organisations.
33. In addition, each registered charity will be required to lodge an Annual Information Statement with the ACNC. Much of the information included in the Annual Information Statement (and any financial statements lodged with the ACNC) will be made available to the public via a public information portal hosted on the ACNC website. There will be an obligation to keep this information up to date.
34. Another area of concern relates to those who are responsible under the legislation for complying with these requirements (ie responsible individuals). In the Exposure Draft “responsible individuals” are defined very broadly to cover individuals who exercise roles similar to the directors and officers of a company under the Corporations Act 2001. In its submission, the Standing Committee indicated that this definition was inappropriate in the NFP context for a number of reasons. For example, unlike many for-profit corporations, NFP entities often call on a broad range of individuals, often volunteers, to become involved in various decision making processes of the entity. This is particularly the case with small charities such as churches. A very broad definition of “responsible individual” has the potential to impose governance obligations on a significant number of persons beyond the governing council of the entity. It is not clear whether the concerns expressed by the Standing Committee will be addressed in any bill introduced into the Parliament.
35. More positively, Treasury appears to have agreed that closely related charities (for example, charitable trusts which have the same trustee) should be able to report to the ACNC on a consolidated basis rather than on an entity by entity basis. However it appears that registration of charities with the ACNC will still need to be undertaken on an entity by entity basis.
36. It is expected that the final bill for the ACNC Act will be introduced into Parliament in June 2012, although it is not expected to commence until 1 October 2012.

Governance framework for not-for-profit sector

37. In December 2011, the Treasury issued a Consultation Paper entitled "Review of Not-For-Profit Governance Arrangements". The purpose of the Consultation Paper was to seek comment on governance arrangements that should apply across the NFP sector, again to improve public trust and confidence in the sector.
38. The Standing Committee made a submission in response to the Consultation Paper in January 2012. The principal concern expressed in the submission was that the governance standards contemplated in the Consultation Paper were based on for-profit corporate models and would not be sufficiently flexible or broad enough to cover the diverse range of entities in the NFP sector. A key recommendation in the submission was to defer finalising the governance standards until 1 July 2013 and not to attempt to include the governance standards in the ACNC Act which is due to come into effect on 1 October 2012.
39. The Treasury has not yet released the governance standards it proposes should apply across the sector. However it is likely that such standards will include a requirement to include in an entity's governing rules a statement of the entity's purpose and a statement of the duties that the responsible individuals (or directors) for the entity must exercise, namely duties of care and skill, good faith, not misusing position and disclosure of personal interests.
40. There is a need to ensure that any governance standards that are imposed on entities address real rather than perceived risks and that governance standards are appropriate for all types of NFP entities, ranging from small churches to very large welfare agencies. The risk is that a number of standards proposed will have the effect of raising compliance costs without returning any material benefit to the sector.

Charitable fundraising reform

41. In February 2012, Treasury released a Discussion Paper on reform of charitable fundraising regulation. The closing date for submissions is 5 April 2012.
42. The primary matter raised in the Discussion Paper is the introduction of a uniform set of rules for charitable fundraising across Australia. The reform is being sought particularly by those charities which engage in public fundraising in more than one State or Territory.
43. While the existing rules for charitable fundraising currently vary from State to State, in NSW, for example, there is a complete exemption from fundraising provisions of the Act for religious institutions which have been proclaimed under the Marriage Act 1961 and those bodies affiliated with such institution. In the event that uniform fundraising rules are introduced, it is unlikely that the current exemption enjoyed by religious institutions and their affiliates in NSW would be retained.
44. One issue that will need to be considered is the extent to which public fundraising in the form of offertories in churches will be regulated under the new rules. The Discussion Paper indicates that it may be unnecessary to regulate offertories from members of a church. However the implication that offertories from non-members should be regulated raises obvious and considerable practical difficulties in view of the public nature of our services.

Public ancillary funds

45. In July 2011, the Treasury issued an exposure draft for changes to the trusteeship and other requirements relating to public ancillary funds. Public ancillary funds are funds to which donations can be made on a gift deductible basis and from which the trustees can make distributions to any other entities with deductible gift recipient status. To this extent they offer a useful conduit for receiving donations in a tax effective manner and distributing them for a variety of purposes.
46. A number of parishes in the Diocese have established public ancillary funds. Typically the trustees of such funds are the wardens of the church. The Roman Catholic Church makes very extensive use of these funds at a parish level where the parish priest is typically the trustee of the fund.

47. The changes proposed in the exposure draft came into effect in 1 January 2012 and provide, among other things, that any new public ancillary fund can no longer have individuals acting as trustees of the fund but must instead have a "constitutional corporation" as trustee. The changes therefore prevent individuals such as wardens acting as the trustees of any new fund. The reason for this change is to ensure that the Australian Tax Office is given a constitutional basis for exercising a wider range of regulatory functions in relation to public ancillary funds, including the removal and appointment of new trustees and the issuing of administrative penalties against funds.
48. Parishes were advised about the full impact of these changes in a circular sent to ministers and wardens via email on 19 January 2012. A copy of this circular can be found at www.sds.asn.au under "For Wardens and Parish Councillors".
49. The submission made by the Standing Committee in response to the proposed changes argued that the requirement that trustees of new public ancillary funds must be a constitutional corporation will create uncertainty and, in the context of Anglican parishes, is likely to make the establishment and operation of new funds practically impossible. Accordingly it was requested that consideration be given to granting an exemption from the new requirements in respect of certain funds operated by religious organisations.
50. A similar submission was made on behalf of the Australian Catholic Bishops' Conference.
51. Following discussions with Treasury, a joint request was made by the Anglican Diocese of Sydney and the Australian Catholic Bishops' Conference for a regulation which would give religious bodies a limited exemption from the requirement to have a constitutional corporation as trustee of any new funds.
52. Treasury is yet to respond to the form of regulation that was drafted as part of this request.

NFP Sector Tax Concession Working Group

53. The Federal Government has recently established a NFP Sector Tax Concession Working Group to review the best way to provide tax concessions to the NFP sector. One recommendation that may be considered by the Working Group is the feasibility of a US-style approach to tax concessions for charities by extending to all charities, including religious charities such as churches, deductible gift recipient (DGR) status. While this recommendation appears to be a positive endorsement of the value of the work undertaken by the sector, any extension of DGR status could well be accompanied by a winding-back of the FBT concessions that currently apply to the sector.
54. Members of this working group include Anne Robinson (Prolegis Lawyers) and Brian Lucas (General Secretary for the Australian Catholic Bishops Conference). It is expected that there will be a call for submissions to the Working Group prior to December 2012.

DGR school buildings funds

55. The previous matters related to changes in the law initiated by the Federal Government. However the ATO has the capacity to have a very significant impact on the sector in the way it chooses to administer laws relating to tax concessions extended to the sector.
56. A draft ruling recently issued by the ATO in relation to DGR school building funds is an example.
57. The Income Tax Assessment Act 1997 makes provision for - public funds that are established and maintained solely for providing money for the acquisition, construction or maintenance of a building used, or to be used, as a school or college - to be endorsed as deductible gift recipients (DGR). This means that when a person makes a donation to such a fund they can claim a tax deduction equivalent to the amount of the donation. The meaning of "school" in this context has been interpreted by the courts to include activities such as Sunday school, Bible Study, ESL classes and so forth. Many churches have established school building funds to assist in fundraising for the construction and maintenance of church halls and multi-purpose buildings.
58. On 5 December 2011 the Australian Taxation Office withdrew *Tax Ruling 96/8W - Income Tax: school and college building funds*. This ruling provided that in order to qualify as a school building a building had to be used for the purposes of a school for more than 50% of the time that it was in use. The ATO has released a draft ruling to replace TR 96/8W which will substitute the more than 50% use test with a

requirement that the building be used solely for the purposes of a school (except for use which is minor or occasions or integral to use as a school). This may potentially mean that many buildings that were school buildings under the old ruling will no longer qualify as school buildings under the new ruling.

59. The Sydney Property Trust consider that the new test proposed by the ATO is wrong in law and has written to the ATO expressing this view. A number of legal practitioners in the charities space consider likewise. The primary issue is that the tax legislation only requires that the fund be *solely* used for the acquisition, construction and maintenance of school buildings and does not require buildings themselves be solely used for the purpose of a school.
60. Presently the ATO has not indicated that it is willing to 'grandfather' existing school building funds meaning that on and from the date the new ruling comes into effect existing funds will need to be reassessed against the new ruling. If they do not comply they will be liable to dis-endorsement. Such an outcome would be of great concern. For example, there are a number of parishes in the Diocese of Sydney that have embarked on school building projects in reliance on having had public funds endorsed as DGRs under the terms of the former tax ruling. They have incurred considerable expense in having plans drawn, lodging development applications, entering into building contracts and so forth. The budgeting for these projects is predicated on being able to offer tax deductibility to donors.
61. Parishes were advised in full about the potential impact of this ruling in a circular sent to ministers and wardens on 5 March 2012. A copy of this circular can be found at www.sds.asn.au under "For Wardens and Parish Councillors".

ROBERT WICKS
Diocesan Secretary

30 March 2012