

Resource Paper to support coordinated response to Treasury's Discussion Paper on Tax Deductible Gift Recipient Reform Opportunities

Introduction

The Australian Treasury has released a discussion paper which examines possible reforms to the 'deductible gift recipient' (DGR) framework.

The DGR framework is set out in the *Income Tax Assessment Act 1997 (Cth)* and specifies which charities and other organisations can receive gifts for which the donor can claim a tax deduction. Access to DGR status means that a charity can attract donations more easily.

Therefore, it is important that any proposed changes are carefully examined and that charities make submissions in response to the discussion paper so that their views are made clear.

The discussion paper includes some sensible and non-controversial proposals. However, it also includes some concerning proposals and the purpose of this document is to **address those concerning proposals and to encourage charities to adopt a consistent response to them.**

Issue 1 – Focus on Activities Rather than Purpose

Background

The common law of charity focusses on 'purposes' of the organisation for classification as a charity. Purposes, as stated in the organisation's formal documents, such as its constitution, are the starting point for inquiries as to whether it is charitable. Activities are deemed to be a second tier enquiry—used as indicators or signposts as to the purpose of an organisation. Activities are not the initial starting point of inquiry. This has been accepted by the ACNC legislation where the principal charity registration section¹ is expressed in terms of purpose with one exception.²

Charity activities are the activities that a charity undertakes in support of its overarching purpose. A charity may only conduct activities that further its charitable purposes.

The ACNC gives the following example:

A charity holds a cake sale to raise funds for its homeless accommodation. The activity – baking cakes and selling them to the public – is not the same as its overarching purpose – advancing social and public welfare. The cake sale would simply be an activity the charity undertakes to further its charitable purpose of advancing social and public welfare. ([ACNC Fact Sheet](#))

A purposes approach allows the governors of charities to devote charitable resources to the most efficient and effective way of achieving their purposes. This allows flexibility that a pure activities approach might not allow. Further, a focus on activities can easily descend into a complex and unsatisfactory rules based exercise rather than a principles based inquiry that is far more suited to the classificatory task.

¹S 25-5 Australian Charities and Not-for-profits Commission Act 2012

² The one exception is Harm Prevention Charities which have a principal purpose test.

Furthermore, an activity not in furtherance of a charitable purpose of itself, without more, does not mean the charity has abandoned its purposes. The ACNC says: 'In determining whether a charity has a disqualifying political purpose, the ACNC will consider all the relevant circumstances of the charity, including its governing rules and its activities. Assessment of these matters will be a question of fact and degree.'

The discussion paper confuses 'charitable purpose' and 'activities of charities' which is inconsistent with the existing approach to charity law and leaves open the possibility of reforms that bring significantly higher levels of scrutiny to lawful activities – such as advocacy – and cast doubt over the legitimacy of those activities.

Key Messages

1. *In the discussion paper both charitable purpose and charitable activities are raised. Charity law focuses on purposes and not activities, and the DGR framework generally has a focus on purpose rather than activity. As such, and in the absence of strong and compelling reasons to the contrary, the focus of DGR reform should likewise focus on purposes – such strong and compelling reasons do not exist and therefore no shift in focus towards activities such as advocacy is warranted (see Issue 2).*
2. *The current legal regime is robust in outlining the purposes for which charities can legitimately be established, as well as, in ensuring charities must demonstrate that they do not have a 'disqualifying purpose.'*^[1]
3. *Furthermore, the regulatory environment does account for other, relevant laws, which further specifies prohibitory conditions on DGRs in pursuing their purpose.*^[2]
4. *We therefore **strongly oppose** the activity-level focus in the review (as suggested in questions 4-6; 12-13 of the discussion paper) as such an approach:*
 - a. *Casts doubt and uncertainty over what activities a DGR entity can lawfully undertake resulting in a chilling effect;*
 - b. *Insufficiently establishes that the current regime of 'charitable purpose' is not robust for regulating the sector.*

Issue 2 – Erosion of the Right of Charities to Undertake Advocacy

Background

Australian charities can undertake advocacy to further their charitable purposes, for example through supporting or opposing relevant government policies and decisions. The importance of this was recognised by the High Court in the *Aid/Watch*³ decision of 2010, where the Court held that charities

^[1] Disqualifying purpose includes: a purpose to promote/oppose political parties/candidates; a purpose to engage in or promote unlawful activity; a purpose to engage in or promote activities contrary to public policy (which does not include opposing specific policies of the Government). See ACNC Fact Sheet http://www.acnc.gov.au/ACNC/Reg/Charities_elections_and_advocacy.aspx

^[2] In regards to OAGDS, for example, organisations must demonstrate compliance with the 2006 Anti-Money Laundering/Control of Terrorism Financing Act, and the Criminal Code vis-à-vis extraterritorial powers in relation to child sex tourism.

³ See *Aid/Watch Incorporated v Commissioner of Taxation* [2010] HCA 42, available at <http://www.austlii.edu.au/au/cases/cth/HCA/2010/42.html>

undertaking advocacy was essential to Australia's constitutional system of parliamentary democracy. This decision was subsequently legislated in the *Charities Act 2013*.

The Act also prescribes the limits to charitable purpose; for example, charities can't have a purpose of endorsing or supporting parties or candidates for political office or promoting unlawful activity. The ACNC has published [guidance](#) on this issue which can assist charities to understand what is permissible and what isn't.

The discussion paper seeks to treat advocacy as different to other activities undertaken by charities by seeking views regarding a proposal for new reporting obligations for advocacy activities (consultation questions 4-6).

The discussion paper also seeks views on a proposal to limit the level of advocacy undertaken by environmental organisations by requiring them to allocate 25% - 50% of their donation revenue on environmental remediation (consultation question 12).

Key Messages

- 1. Charities undertaking advocacy has been recognised as both a legitimate activity and one essential to our system of parliamentary democracy.*
- 2. It is an important approach which charities can use to address the causes of social and environmental problems, rather than just the symptoms – this often requires policy change.*
- 3. For example – if a factory is polluting a river because of poor regulation, environmental remediation work to treat affected wildlife downstream will have little impact if the factory can keep polluting the river – this will require advocacy to ensure the factory complies with regulations or adequate regulations are introduced.*
- 4. No evidence has been put forward as to the need for new reporting obligations for advocacy activities – therefore they are **strongly opposed** on the basis that they would impose new and unjustified red tape on charities.*
- 5. The discussion paper asserts that 'some charities and DGRs undertake advocacy activity that may be out of step with the expectations of the broader community' – this assertion is made without any supporting evidence. Unsubstantiated and speculative statements about the expectations of the broader community should not serve as a basis for making public policy.*
- 6. Requiring that a certain proportion of an environmental organisation's activities be directed towards environmental remediation represents an intrusion on the autonomy of environmental organisations and amounts to government trying to 'pick winners' in terms of what approaches charities should use to achieve their charitable purpose. Charities and their supporters are in the best position to determine what approaches are most appropriate in order to achieve their charitable purpose – therefore any new restrictions and limitations are **strongly opposed** on the basis that they would impose new and unjustified red tape on environmental charities which will make it harder for them to achieve their charitable purpose.*
- 7. Well targeted and proportional approaches to maintain transparency and accountability for charities are supported and this can be achieved by ensuring all DGRs are registered as charities under the purview of the ACNC, as the discussion paper proposes.*
- 8. Existing charity law sets appropriate boundaries for what advocacy activities by charities are acceptable, and the ACNC guidance for charities is helpful and reflective of the law – no further changes are justified or necessary.*

Issue 3 – Introduction of Reviews and Audits to investigate continual compliance with DGR requirements over-time

Background

The discussion paper indicates a concern that without a formal review process for periodically re-assessing DGR eligibility, organisations that have been DGR-endorsed in perpetuity (which represents most DGRs) are accessing DGR benefits without meeting the eligibility criteria. This concern is framed around assurances to the donors and in light of the ‘generous concessions’ provided.

Currently the ATO encourages DGRs to self-review annually or when circumstances change, but in practice, the ATO does not have visibility of ongoing compliance with criteria unless they undertake a review or audit of a DGR – which they can do.

The paper proposes that there be periodic reviews of all DGRs, over five-year timelines, and that on the basis of a desk review by ACNC and ATO organisational audits for compliance be undertaken – starting with those identified as high risk.

Key Messages

1. *We welcome and accept that the transparency and accountability of DGRs is important. However, we believe reviews and audits should be conducted only at the point where systemic issues have been identified and/or certain risk thresholds amongst categories of charities and DGRs have been surpassed.*
9. *At present 92% of DGRs are registered with the ACNC. That means 25,760 of 28,000 DGR entities are already governed by the ACNC regulatory framework, which requires annual reporting. The discussion paper proposes to require all DGRs (except government entities) to be registered as charities, and this will bring in even more DGRs under the ACNC regulatory framework.*
2. *A rolling review and audit process is costly and the case has not been made that such a cost is justified given the current nature of the risk. The ACNC and the ATO already have the power to undertake reviews and audits where they believe they are warranted, and it is not apparent that introducing new and costly formal review processes is necessary.*
3. *We therefore **strongly recommend** a proportionate and risk-based response to this issue. Such a response would include requiring DGRs to be registered with the ACNC (as the discussion paper proposes), with the ACNC and the ATO using their existing compliance approach to ensure compliance with the law. This can involve undertaking reviews and audits using their existing powers where systemic issues have been identified and/or certain risk thresholds amongst categories of charities and DGRs have been surpassed.*

The expertise of the ACNC and ATO should be respected, and they should be allowed to independently determine what types of reviews and audits are necessary, and in what circumstances. The government should not interfere with their independence and second guess their expertise in this regard.

Issue 4 – Creating certainty and trust in the regime requires addressing other areas of regulation

Background

Integrity and transparency are important features of the sector and critical to its ongoing viability and sustainability. However, the current provisions with relation to section 50-50 of the *Income Tax Assessment Act 1997*, place unnecessary compliance risk on charities, despite the introduction of Tax Ruling 2015/1, through governing rules and sole purpose conditions.

The special conditions were enacted, with effect from 1 July 2013, in Tax Laws Amendment (2013 Measures No 2) Bill 2013. These conditions require that an entity:

- a) comply with all the substantive requirements in its governing rules; and

- b) apply its income and assets solely for the purpose for which the entity is established (the solely condition).

The key concerns with these conditions include:

- If a purpose is incidental or ancillary to the original purpose for which a charity is formed, it is arguable that charity may fail the solely condition. This is the plain and ordinary meaning of the word 'solely'.
- For NFPs that are not charities, the sole purpose requirement is not the correct test and the 'dominant' purpose requirement has been accepted by the Courts. The enactment of the special conditions has fundamentally altered the basis on which income tax exemption for NFPs is determined.
- For the governing rules condition, it is difficult to say that any legislative requirement is not substantive.
- Both the governing rules condition and the solely condition operate with a guillotine effect, in the sense that (a) it is not possible to substantively comply with the substantive requirements in the governing rules; and (b) the solely condition will be failed wherever there is a misapplication of income or assets, irrespective of intention or amount.
- If some form of audit and review process is introduced, as the discussion paper proposes, the current wording of section 50-50 means that there is a high risk that many charities and DGRs could lose their endorsement given the very narrow drafting of the section.
- For example, a charity which also runs a for-profit business to generate income which is used to further their charitable purpose could fail the 'apply its income and assets solely for the purpose for which the entity is established' test and hence lose access to tax concessions associated with being a registered charity.

Key Messages

1. *The success of integrity measures such as rolling reviews are predicated on the sector being clear around their obligations with regard to both the Australian Charities and Not for profits Commission Act 2012 and Income Tax Assessments Act 1997.*
2. *It is important that any reform of the DGR framework also include reform to section 50-50 of the Income Tax Assessment Act 1997. Such reforms should have the outcome of:*
 - (a) *repealing the governing rules condition;*
 - (b) *including a common rule that says, for the avoidance of doubt, that the 'solely' condition is not breached where an entity pursues purposes or conducts activities that are incidental or ancillary to a purpose for which the entity is established*