Australian Government

The Treasury

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

Supplementary submission by the Australian Treasury

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SUPPLEMENTARY SUBMISSION – INTRODUCTION

1. Treasury provided submissions to the Parliamentary Joint Committee on Corporations and Financial Services and the Senate Community Affairs Legislation Committee inquiries into the Australian Charities and Not-for-profits Commission Bill 2012, the Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill (ACNC Bills) and the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012. Treasury also appeared before the Committees on 3 and 4 September 2012 respectively.

2. Below is Treasury's response to questions taken on notice and matters upon which clarification was sought.

Advice provided by the Advisory Board

3. Some stakeholders expressed some uncertainty over the operation of the provisions which outline the role of the Advisory Board in providing advice under the ACNC Bill.

4. The ACNC Bill establishes an Advisory Board to provide sector-specific advice to the ACNC Commissioner, and to assist the ACNC Commissioner in her or his decision-making role.

5. The Advisory Board's function is to provide advice and make recommendations in response to requests from the ACNC Commissioner. [Subsection 135-15(1)]

6. While the ACNC Commissioner may have regard to the advice and recommendations of the Advisory Board, the Commissioner is not obligated to act in accordance with this advice. [Subsection 110-20(1)]

7. This reflects that the Advisory Board is not a governing body. The Advisory Board cannot provide advice that is not in response to a request from the ACNC Commissioner, rather it is the ACNC Commissioner who is responsible for making decisions on behalf of the ACNC and seeking advice where appropriate.

8. This is consistent with Commonwealth accountability frameworks for regulatory bodies, consistent with the *Financial Management and Accountability Act 1997*, and Commonwealth regulators are structured in this way so that appropriate mechanisms to ensure accountability are in place.

9. While the Advisory Board has no decision-making power, it is intended to provide a valuable resource for the ACNC Commissioner, as it can provide the ACNC Commissioner with a pool of broad knowledge and experience in the NFP sector, which the ACNC Commissioner can draw on to assist her or him to effectively fulfil the role of ACNC Commissioner.

10. It should be noted that the provisions relating to how the Advisory Board provides advice do not hinder or restrict Advisory Board members expressing views to the ACNC Commissioner in their personal capacity or another capacity, separate from their role as Advisory Board members, for example, as stakeholders.

11. Just as other stakeholders can express their views to the ACNC Commissioner, this also applies in the case of members of the Advisory Board.

Effect of the removal of the governance standards, external conduct standards and financial reporting framework from the ACNC Bill

12. The Australian Charities and Not-for-profits Commission Bill 2012 sets up the framework for a minimum set of governance standards, and a minimum set of external conduct standards, which an entity must satisfy in order to be and remain a registered entity. The Bill also sets up a financial reporting framework for registered entities.

13. The Government announced on 17 May 2012 that the financial reporting framework and governance standards, including the external conduct standards, will commence on 1 July 2013.

    13.1. The Government will consult on the content of financial reports and the governance and external conduct standards, including with key stakeholders and advisory bodies such as the NFP Sector Reform Council and the public more broadly.

    13.2. The two-staged approach means that the financial reporting requirements and governance standards for registered charities will not come into effect until 1 July 2013. The extended start dates will give more time for charities to transition to the new regulatory framework and for the ACNC to provide guidance materials to help with the transition. The first financial reports will not need to be lodged with the ACNC until 31 December 2014.

14. Removal of the financial reporting framework and governance framework and external conduct framework from the ACNC Bill would:

    - reintroduce regulatory duplication between Commonwealth regulators;
    - undermine the 'one-stop shop' element of the ACNC, requiring many of the consequential amendments to be undone;
    - undermine the consultation process agreed with the States and Territories;
    - not allow time for consultation prior to the introduction of the standards or the content of the reporting requirements in the ACNC Bill by the announced start date. Any delay to the announced start date of 1 July 2013 will result in an incomplete register, and would also make the information portal less useable for the public; and
    - mean significant re-working of the ACNC Bill, which would delay the start date.

15. The ACNC Bill creates a 'one-stop shop' for eligible NFP entities that are seeking access to tax concessions, consistent with the Government's announcements, to make ACNC registration a precondition where charities seek access to Australian Government exemptions, concessions or benefits available to charities.

    15.1. However, the removal of the governance and reporting framework from the Bill would require many of the consequential amendments to the Bill, designed to eliminate duplication, such as those in the *Corporations Act 2001* (Corporations Act) which, for example, remove the directors' duties on responsible entities and require financial reports to be prepared and lodged, to be reversed.

    15.2. Many of these consequential provisions were agreed with other Commonwealth Departments on the basis that the ACNC Bill includes the

framework for requiring that governance standards must be met by registered entities. The removal of this framework would necessitate that these amendments to be reversed.

16. In the process of developing the consequential amendments to the Corporations Act, the Government consulted with the States and Territories, and sought their approval under the Corporations Agreement 2002 for the amendments. Any reversal of these amendments to the Corporations Act would undermine the Government's prior negotiation and consultation strategies that have been agreed with the States and Territories, and would require further approval from the States and Territories.

17. In addition, removing the governance framework and reporting framework from the ACNC Bill, and including the governance standards and reporting requirements in primary legislation would not allow sufficient time for public consultation prior to a 1 July 2013 start date, as the amendments would need to be introduced into Parliament in the Autumn sittings in order to be in place prior to the announced start date. Any delay to the announced start date of 1 July 2013 will result in an incomplete register, and would also make the information portal more difficult to use for the public.

18. The governance standards are a requirement of registration, and a registered entity's prolonged non-compliance with a governance or external conduct standard could lead to the ACNC Commissioner revoking an entity's registration. As such, the governance standards are mentioned in many sections of the ACNC Bill, as are the reporting requirements, including the Registration, Enforcement Powers, Duty to Notify chapters and the Finance and Reporting chapters. Removal of the governance standards framework and reporting framework would require a re-write of several sections of the ACNC Bill, and may push the commencement of the ACNC back from 1 October 2012 due to timing issues associated with drafting those changes needed to remove the frameworks.

The use of the terms "public trust" and "confidence" in the ACNC Bill

19. The terms "public trust" and "confidence" have their ordinary meaning and are used throughout the ACNC Bill to refer to the positive ways in which the Australian public views the NFP sector.

20. The explanatory materials provide a detailed discussion of how this principle can be understood and how it is used in the ACNC Bill, including the high regard that the Australian community has for the NFP sector, and the way the Bill aims to support public trust and confidence in the NFP sector, for example, through the regulatory framework and the publicly available Register.

21. It is important to note that the concept of "public trust and confidence" is not used as a test to trigger any of the ACNC regulatory powers or to provide grounds for the revocation of the registration of an entity.

22. Rather, the issue of "public trust and confidence" is one of a list of policy matters that the Commissioner must consider prior to using any of the enforcement powers or revoking registration.

    22.1. This list of factors also includes considering factors such as what other actions could be taken to remedy contraventions or non-compliance with the Act and the welfare of members of the community that receive benefits from the entity.

22.2. It is also important to note that there are stringent statutory thresholds, including application and necessity clauses, which must be met before regulatory powers can be exercised by the ACNC Commissioner and before any revocation of registration of an entity. Additional information on this is provided in paragraphs 47 to 51 of Appendix A.

22.3. In addition the ACNC Bill provides an extensive review and appeal framework in relation to decisions about registration and the use of enforcement powers taken by the ACNC Commissioner. These processes cater for both internal and external merits review as well as judicial review, and are explained in detail in Chapter 12 of the Explanatory Memorandum.

Definition of not-for-profit entity

23. In the past, the Commissioner of Taxation has generally accepted an entity as being not-for-profit where its constituent or governing documents or the operation of law (for example, a statute governing the organisation) prevent it from distributing profits or assets for the benefit of particular people — both while it is operating and when it winds up. Any surplus made by an entity must be directed towards carrying out the entity's purposes.

24. However, the fact that a not-for-profit entity may make a profit does not negate its not-for-profit status so long as any surplus is applied to the not-for-profit purposes of the entity and the profit does not accrue to the benefit of identifiable members either directly or indirectly.

25. There is currently no single definition of not-for-profit entity in the tax laws, however, there are a few similar definitions, and a common understanding.

25.1. For example, the current definition of 'non–profit company' in the *Fringe Benefits Tax Act 1986* is 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.

25.2. The current definition of non-profit company in the *Income Tax Act 1986* (which is the definition referred to in the *Income Tax Assessment Act 1997*) is either 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 a friendly society dispensary.

26. The Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 standardises the term 'not-for-profit', replacing the defined and undefined uses of 'non-profit' throughout the tax laws.

27. The new definition requires that, to be a not-for-profit entity, an entity must:

- be an entity that is not carried on for the profit or gain of its owners or members, neither while it is operate nor upon winding up; and

- under an Australian law, foreign law or the entity's governing rules, it is prohibited from distributing, and does not distribute, its profits or assets to its owners or members (whether money, property or other benefits), neither while it is operating nor upon winding up, unless the distribution is made to another

not-for-profit entity with a similar purpose, or it is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.

28. The definition adopted in the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 is based on the current understanding of a not-for-profit entity, and has been subject to two rounds of public consultation.

29. Following consultation, the definition was broadened to allow distributions to other not-for-profit entities, and to owners and members for genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity. For example, this allows a minister of a not-for-profit congregation to be paid a stipend for the services of being the minister, or the entity to provide some funds to another congregation.

30. Not-for-profit entities have previously been prohibited from distributing to owners and members, in their capacity as members. This requirement is nothing new, and is at the heart of what a not-for-profit entity is. An entity which breaches the new definition because they distribute to their owners and members would not currently meet the definition of a not-for-profit entity.

31. Importantly, an entity would not be in breach of the definition of not-for-profit if a member benefits, not in their capacity as a member, but in their capacity, for example, as a welfare recipient.

32. For example, a church which provides assistance and relief to several members of the parish as part of its broad provision of support to the local community who are in charitable need as a result of a natural disaster would not be in breach of the definition of not-for-profit.

33. The submissions on the second round of public consultation demonstrated broad sector support for the definition of not-for-profit entity currently included in the Bill.

34. The definition in the Bill is consistent with the ATO's existing public rulings and recent judicial interpretations of not-for-profit.

Arts organisations specifically exempted from the 'in Australia' special conditions

35. The Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 specifically lists in the 'international affairs' category the Australian Chamber Orchestra Pty Ltd (ABN 45 001 335 182) and the Sydney Dance Company (ABN 59 002 707 897), which are designated international touring organisations.

36. The exemption from the 'in Australia' special conditions is contingent on the overseas activities of these organisations remaining under 25 per cent of their overall activities. These specific listings will be reviewed in three years' time.

37. Treasury has sought background information from the Office for the Arts on the history of the international touring organisations classification.

38. "International touring" was one of five categories established by the 1999 Major Performing Arts Inquiry, for classifying Major Performing Arts companies.

39. Four companies were designated as international touring organsiations, these were; Australian Chamber Orchestra, Bangarra Dance Theatre, Sydney Dance Company and Circus Oz.

40. For an organisation to fall within this category it must have been assessed as being internationally competitive, performing internationally and in Australia each year, (with international performances constituting at least 15% of performances) and the financial position of the company supports international tours.

41. In 2011, a new National Framework for Governments' Support of the Major Performing Arts Sector discontinued the categories (including the international touring category).

APPENDIX A – REGULATORY POWERS

42. The information provided below was tabled at the Committee hearings.

Australian Charities and Not-for-profits Commission (ACNC) regulatory powers

Introductory information

43. There are a range of regulatory powers and sanctions available to the ACNC Commissioner in the ACNC Bill. The regulatory powers and sanctions enable the ACNC Commissioner to respond appropriately to the facts of each case and to conduct regulatory oversight in an effective manner.

44. The regulatory powers and sanctions are based on the powers of existing regulators which oversee different entities and activities of the NFP sector, including the Australian Taxation Office (ATO) and the Australian Securities and Investments Commission (ASIC).

45. Ensuring that the ACNC has similar regulatory powers is essential for the ACNC to effectively take on the regulatory roles previously performed by these other regulators. Without the necessary powers the ACNC would not be able to take on the roles of these other regulators and therefore function as a one-stop shop regulator for the NFP sector.

46. The regulatory powers include information gathering and monitoring powers, the ability to give entities warning notices, the ability to issue directions, the ability to accept enforceable undertakings, the ability to apply for injunctions and the power to suspend or remove a responsible entity.

47. There are stringent statutory thresholds, including application and necessity clauses, which must be met before regulatory powers can be exercised by the ACNC Commissioner.

48. The 'application clause' constrains the provisions the ACNC Commissioner is able to enforce, and the types of entities the ACNC Commissioner is able to apply enforcement powers toward.

49. The 'necessity clause' ensures that the ACNC Commissioner can only use enforcement powers when use of the power is necessary to directly address the contravention.

50. The ACNC Bill also requires the Commissioner to consider a number of factors before using such powers, these factors include:

    - the nature, significance and persistence of any contravention of the Act or non-compliance with a governance standard or external conduct standard;

    - what action the Commissioner, the registered entity, or any of the responsible entities of the registered entity, could take or have taken to address any such contravention or non-compliance or prevent any similar contravention or non-compliance; and the welfare of any members of the community that receive direct benefits from the registered entity.

51. See subsection 35-10(2) of the ACNC Bill for further details.

52. In the first instance the ACNC will rely on education to encourage compliance with the new provisions. This approach was outlined in the ACNC Implementation Report and is reflected in the provisions of the Bill which require the Commissioner to consider the factors outlined above.

53. In more serious cases the type of enforcement power used by the Commissioner will be determined by the kinds of actions which are required to address the contravention.

54. The table below provides a high level comparison between the existing default regulator at the Commonwealth level, the ATO, and the ACNC. Some of the powers outlined below are based on other Commonwealth regulators, for example the Australian Competition and Consumer Commission (ACCC), the Australian Prudential Regulation Authority (APRA), particularly where the ATO has no equivalent power.

55. One of the findings of the *Scoping Study for a National Not-for-profit Regulator* was that the lack of proportional powers available to the ATO was unsuitable for the NFP sector, as it means that in some instances the only enforcement mechanism available (the revocation of charitable status and loss of access to tax concessions) is inappropriately harsh and disproportionate.

Summary table - comparison between the ACNC and existing Commonwealth regulators

ACNC regulatory power	Reference	Comparison to other Commonwealth regulators
Information gathering	ACNC Bill — Division 70	The powers of the ATO are much broader in this area and are not explicitly restricted to the collection of information for the administration of the tax laws There is no minimum threshold before the ATO uses these powers The ACNC affords stronger procedural fairness protections, including minimum time periods for entities or individuals to provide relevant and required information or documents The tax laws abrogate the privilege against self-incrimination without providing the protections afforded to individuals under the ACNC Bill
Monitoring powers	ACNC Bill — Division 75	The powers of the ATO are much broader in this area There is no minimum threshold that needs to be satisfied before the ATO uses these powers The ACNC affords stronger procedural fairness protections including minimum time periods for entities or individuals to provide required information, and provides the occupier of the premises with rights and protection (for example compensation for damage to electronic equipment) The tax laws abrogate the privilege against self-incrimination without providing the protections afforded to individuals under the ACNC Bill The ATO is able to use monitoring powers without the need for warrants. The tax laws do not clearly specify the rights, protections and responsibilities of occupiers and establish a framework which includes external oversight — the provisions that specify the rights, protections and responsibilities of occupiers adds detail and length to the ACNC Bill, however, these provisions are required to provide affected parties with adequate protection Also note that the provisions which establish the monitoring framework in the ACNC Bill is likely to become the precedence for all monitoring power regimes to be included in future Commonwealth legislation
Ability to	ACNC Bill	There is no general ATO equivalent power – the ATO

ACNC regulatory power	Reference	Comparison to other Commonwealth regulators
give entities warning notices	— Division 80	has to use harsher enforcement mechanisms e.g. loss of access to tax concessions. Charities regulators in overseas jurisdictions generally have the authority to issue warning notices and to publish these notices (for example, charities regulators in the United Kingdom and New Zealand). ASIC also has the power to issue public warning notices with the power broadly consistent with the proposed ACNC powers Unlike these overseas regulators and ASIC, the ACNC Commissioner is required to give entities at least 14 days to respond to a warning notice prior to publishing the notice
Directions	ACNC Bill — Division 85	No general ATO equivalent – the ATO has to use harsher enforcement mechanisms e.g. loss of access to tax concessions ATO does have similar powers for self-managed superannuation funds APRA has similar powers for all its regulated entities which can include NFP ADIs and insurance providers. The threshold which APRA has to meet prior to issuing directions are less onerous, with APRA having the authority to issue directions in a broader set of circumstance (i.e. when APRA considers that the direction is reasonably necessary), and the authority to direct an entity to take a broader range of actions (i.e. anything else as to the way in which the affairs of the body corporate are to be conducted or not conducted).
Ability to accept enforceable undertakings	ACNC Bill — Division 90	No general ATO equivalent – the ATO has to use harsher enforcement mechanisms e.g. loss of access to tax concessions This power is based on an equivalent ACCC power which are designed to encourage self-correction
Ability to apply for injunctions	ACNC Bill — Division 95	Same as ATO and APRA; provisions provide for the ACNC to apply to a court that ultimately issues and enforces injunctions.
Power to suspend or remove a responsible entity	ACNC Bill — Division 100	The ATO has broader powers in regard to ancillary funds (both charitable and non-charitable funds) and self-managed superannuation funds. The exercise of these powers can be triggered by a contravention of any Australian law, with no procedural fairness. The ACNC on the other hand can only use this regulatory power if it is required to directly address a

ACNC regulatory power	Reference	Comparison to other Commonwealth regulators
		contravention of the ACNC Bill. ASIC and APRA have similar powers