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Dear Mr McClure

Review of Australian Charities and Not-for-profits Commission Legislation

Thank you for inviting my submission to the ACNC legislation Review. I enclose the submission with pleasure and would be happy to elaborate on any aspects.

Yours sincerely

Ian Murray



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Recommendations of Senior Lecturer Ian Murray to the Review Panel for the Review of the Australian Charities and Not-for-profits Commission Legislation

Date: 28 February 2018

1. Recommendations

- (a) The ACNC should be provided with additional funding and administrative support to pursue greater collaboration and coordination regarding NFP regulation with federal agencies and states and territories. The ACNC should, in effect, be aided to become the successor coordinating body to the Office of the Not-for-profit Sector.
- (b) The objects of the ACNC legislation should be amended to reflect what the charity sector is intended to achieve for society as follows:
 - (1) The objects of this Act are:
 - (a) to ensure that the Australian not-for-profit sector achieves public benefit; and
 - (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
 - (c) where incidental or ancillary to objects (a) or (b),
 - (i) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
 - (ii) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.
- (c) If the ACNC regulatory regime is to be extended to NFPs, then:
 - a. NFPs should be defined, consistently with the approach of the Productivity Commission, by reference to pursuit of community purposes, as well as non-distribution of assets.
 - b. Any extension should reflect the distinctive nature of charities, which may require some differences between regulation of NFPs and of charities.
 - c. A potential approach, that could reflect the above two points, is to start with non-charity and non-government entity categories of income tax exempt organisations under Div 50 ITAA97.
- (d) To address gaps in the ACNC's enforcement powers, the ACNC should be provided with funding to investigate the ACNC's ability to access enforcement mechanisms under other legislation or pursuant to the relevant Attorney-General's fiat.
- (e) To promote the continued development of NFP and charity law and of certainty, test case funding should be provided for charity law cases and the ACNC should be given a legislative mandate to provide binding rulings.
- (f) Any reforms to the ACNC legislation should focus on regulating purposes and the processes adopted to pursue those purposes, but not involve merits review of the substance of charity decisions about how to pursue purposes.

2. Harmonisation and Coordination

One of the difficulties of the ACNC legislation review is that the regulation of charities actually takes place pursuant to various pieces of legislation across all Australian jurisdictions. This is unsurprising in that charities vary markedly in their legal forms, activities and purposes.

However, when the Office for the Not-for-profit Sector within DPMC was disbanded in 2013, this left a gap in terms of a body that could pursue greater collaboration and coordination regarding NFP regulation – despite previous Productivity Commission calls for just such a body.¹

The ACNC has partially fulfilled that role, which is supported by the object of reducing unnecessary regulatory obligations. However, any funding or administrative support that could be provided to the ACNC to investigate harmonisation or coordination with other Commonwealth agencies and with States and Territories about the following would make a material difference:

- Financial reporting.
- Tax (including state and territory taxes) endorsement.
- The definition of charity (and of sub-types of charity such as public benevolent institutions).
- Fundraising regulation.
- Legal and reporting requirements under government grant agreements.

To give a sense of the range of different regulatory regimes, note that the Federal Commissioner of Taxation continues to enforce the additional tax endorsement conditions for tax concessions, ACNC registration being merely one of several requirements. Separate tests apply at the state and territory level for charity fiscal concessions such as payroll tax, stamp duty, land tax and council rates. Further, there are other regulators based on legal form, such as the Australian Securities & Investments Commission for companies limited by guarantee, state and territory departments of commerce or offices of fair trading for incorporated associations and state and territory attorneys-general for charitable trusts. Additional regulators and duties may also be relevant to particular types of charities based on their activities. For instance, charities that conduct fundraising activities or that undertake regulated services such as the provision of many health or education services.

¹ Productivity Commission (Cth), ‘Contribution of the Not-for-profit Sector’ (Research Report, 11 February 2010) 369, 378.

Until recently, this regulation has largely developed in an uncoordinated fashion to serve a range of, sometimes overlapping, purposes.² For instance, in 2011 the Scoping Study for a National Not-for-profit Regulator identified over 178 pieces of legislation across all levels of government in Australia, which required 19 separate government bodies to determine charity status.³

The areas of incorporated association reporting, charitable fundraising and eligibility for tax concessions are three of the most significant areas of compliance costs for charities, amounting to almost \$35 million per year for the sector, let alone the administration costs for state and territory government departments.⁴

Achieving greater harmonisation and coordination does not necessitate states and territories abandoning their sovereignty or their control over revenue collection. For example, while the ACNC could determine charity status, states and territories might separately legislate for the relevant classes of charities entitled to tax concessions. This would be consistent with approaches such as that in Western Australia where certain charities do not receive state tax concessions, with this achieved not by changing the definition of charity, but by defining eligibility for state tax concessions by reference to a sub-set of charities.⁵ This would avoid odd outcomes such as the finding that the Law Institute of Victoria was not a charity for state payroll tax purposes, despite being registered as a charity for federal purposes by the ACNC.⁶

Harmonisation and coordination is also fundamental to ensuring that the ACNC is the primary regulator and primary contact point for charities.

3. Regulatory Objects of the ACNC Legislation

To ensure stability in the objects of the ACNC legislation, as well as to enable the ACNC to adopt a coherent regulatory approach, it is suggested that the objects ought to reflect the reasons for existence of the charity sector. That is, to reflect what the charity sector is intended to achieve for society.

The current objects only do this in part and they include objects that are ancillary or subsidiary to the key goals of the charity sector. Research into why the NFP sector (including charities) exists indicates that it is intended to produce goods and process benefits for the public benefit, and to do so independently from government.

² Treasury (Cth), 'Scoping Study for a National Not-for-profit Regulator' (Consultation Paper, 2011) 6-7.

³ Ibid 7.

⁴ Deloitte Access Economics, 'Cutting Red Tape: Options to Align State, Territory and Commonwealth Charity Regulation' (Final Report, 2016) 2-3.

⁵ Under the *Taxation Legislation Amendment Act (No 2) 2015* (WA).

⁶ *Law Institute of Victoria v Commissioner of State Revenue (Vic)* [2015] VSC 604.

The current objects of the ACNC legislation capture the goal of producing process benefits under section 15-5(1)(b) 'to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector'. However, there is no further object that captures the need to produce public benefit and I recommend that an extra object be introduced that reflects this requirement.

3.1. Research on the reasons for existence of the NFP and charity sectors

Various demand-side theories can be grouped together as a 'three failures' – of the government, market and NFP sectors – explanation for the existence of the NFP sector and hence the charity sector within it.⁷ For instance, the market may fail to provide public goods (eg, reduced crime rates arising from the relief of poverty)⁸ or quasi-public goods (eg, a museum exhibition)⁹ due to the free-rider problem; yet due to heterogenous demand and the government's focus on satisfying the desires of the median voter, government will also provide less than optimal levels and varieties of public and quasi-public goods.¹⁰ If some community members consider that a goal such as poverty relief should be achieved by different methods or that more support should be provided to the poor, they will need to associate to achieve this by way of a charity rather than relying on government. Theorists such as Hansmann have emphasised that the market may also fail to provide goods (including private goods) of optimal quality or at optimal levels due to information asymmetries in areas such as health or education, in which case the non-distribution constraint helps explain why NFPs such as charities are trusted to provide the goods.¹¹

There are, of course, social, political and historical rationales for the existence of the NFP sector (and, more specifically, charities) too. These include the participatory role of NFPs in acting as vehicles for formation of preferences and sites of collective and political action in relation thereto.¹² The rationales also encompass the role of NFPs and charities in enhancing pluralism and independence from government.¹³ Pluralism,¹⁴ for example, not only enhances

⁷ Richard Steinberg, 'Economic Theories of Nonprofit Organizations' in Walter Powell and Richard Steinberg (eds) *The Nonprofit Sector: A Research Handbook* (Yale University Press, 2nd ed, 2006) 117.

⁸ Public goods are those that are non-excludable (in the sense that all consumers enjoy free access) and non-rivalrous (in the sense that it can be consumed simultaneously without affecting the consumption of others): Neil Canaday, 'Chapter 25: Public Finance' in Rohna Free (ed), *21st Century Economics: A Reference Handbook* (Sage, 2010) 255, 256.

⁹ Quasi-public goods are typically defined to mean goods featuring one of the two aspects of public goods (ie non-excludability or non-rivalry).

¹⁰ Burton Weisbrod, *The Nonprofit Economy* (Harvard University Press, 1988).

¹¹ Henry Hansmann, 'The Role of Non-profit Enterprise' (1980) 89(5) *Yale Law Journal* 835, 843-5.

¹² Elizabeth Clemens, 'The Constitution of Citizens: Political Theories of Nonprofit Organizations' in Steinberg and Powell, above n 7, 207; Miriam Galston, 'Civic Renewal and The Regulation of Nonprofits' (2004) 13(2) *Cornell Journal of Law and Public Policy* 289, 294-356.

¹³ See, eg, James Douglas, *Why Charity?: The Case for a Third Sector* (Sage, 1983) chs 7, 8.

¹⁴ As to pluralism, see, eg, Nicholas Miller, 'Pluralism and Social Choice' in Robert Dahl, Ian Shapiro and José Antonio Cheibub (eds) *The Democracy Sourcebook* (MIT Press, 2003) 133, 140.

autonomy by providing more choices, but also enables devolution of decision-making and the development of innovative approaches to social problems.¹⁵ Charities and many NFPs also potentially enhance the conditions of autonomy for society as a whole, by permitting and promoting altruism as an alternative mode of acting to governmental administration or self-interested action in the market space.¹⁶ While there is no express altruism requirement in charity law, the requirements that charities be not-for-profit and that they bestow benefits on a section of the public rather than a private class of individuals do emphasise the other-regarding nature of charities.

Turning to doctrinal analysis of charity law, 'charitable purposes' entail the production of public, quasi-public and private goods. While the precise mix is likely to be contested once indirect benefits, or externalities, are taken into account, even the provision of predominantly private goods can be consistent with achieving public benefit. That is because, as identified above, charities have advantages over the market and government sectors in producing private goods in certain situations – thus generating a public benefit from producing those goods in types and quantities closer to optimum levels. In particular, Garton has analysed the various 'charitable purposes' as responding to information asymmetries arising from similar circumstances to those examined by Hansmann for the NFP sector as a whole.¹⁷ That is, where the purpose results in public or quasi-public goods; where the service is a complex one (such as education or health care); and where the purpose results in benefits being provided to persons who will not give feedback to the funders (for instance because there is no connection between the recipient of poverty relief and a donor). Further, the charity law requirement that the pursuit of charitable purposes should result in a net benefit demands that at least a minimum level of goods or process benefits must be produced by charities.

From the above, it is apparent that charities fill gaps both in the production of goods and in enabling what can be termed 'process' benefits, such as collective action, pluralism and other-regarding behaviour. Indeed, supply side theories, which emphasise motivations for forming NFPs, also indicate the special role that other-regarding motives play.¹⁸

3.2. Recommended changes to objects

In addition to the ACNC Act's second object of supporting and sustaining a robust, vibrant, independent and innovative Australian NFP sector, there ought to be one additional object that reflects the goal of producing goods for the public benefit. That is:

¹⁵ See, eg, United Kingdom Cabinet Office, Strategy Unit, 'Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector' (Report, September 2002) 28-31.

¹⁶ See, eg, Matthew Harding, *Charity Law and the Liberal State* (Cambridge University Press, 2014) 78-85.

¹⁷ Jonathan Garton, *Public Benefit in Charity Law* (Oxford University Press, 2013) ch 3.

¹⁸ See, eg, Steinberg, above n 7, 130-1.

To ensure that the Australian not-for-profit sector achieves public benefit.

This does not mean that the ACNC should micro-manage the activities of NFPs, but rather that it should ensure that NFPs are genuinely pursuing their purposes. The focus would therefore be on ensuring that NFP controllers follow the processes that they are required to follow by existing duties, such as trustee or director duties, in pursuing the NFP's purposes. The public trust and confidence and reduction of unnecessary regulatory obligations ought then to be ancillary objects.

Section 15-5(1) would thus read:

- (1) The objects of this Act are:
 - (a) to ensure that the Australian not-for-profit sector achieves public benefit; and
 - (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
 - (c) where incidental or ancillary to objects (a) or (b),
 - (i) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
 - (ii) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

4. Extension of the Regulatory Regime to NFPs Beyond Charities

In the literature, NFPs have been defined in rather different ways. For instance by the Productivity Commission as 'organisations established for a community purpose, whether altruistic or mutual in nature'.¹⁹ Salamon and Anheier define NFPs with greater focus on their structure and operation: organised, private rather than part of government and self-governing, non-profit distributing and voluntary.²⁰

There is clearly much overlap with charities, even if there will be inevitable questions around the edges of the definition of NFP, it being a more amorphous concept.

If the ACNC regulatory regime is to be extended to NFPs, then it is suggested that:

- The Productivity Commission approach of including community purposes within the definition be retained, so as to ensure commonality amongst registered organisations of being purpose-focussed. There may be some queries at the edges here about business cooperatives and the extent to which they have community purposes rather than member-serving purposes, but this issue is not insoluble as demonstrated by

¹⁹ Productivity Commission (Cth), above n 1, xxv, 3-8.

²⁰ Lester Salamon and Helmut Anheier, 'Toward a Common Definition' in Lester Salamon and Helmut Anheier (eds), *Defining the Nonprofit Sector: A Cross-National Analysis* (Manchester University Press, 1997) 29, 31-4.

*FCT v Co-op Bulk Handling*²¹ and by the various professional association charity law cases.

- Any extension should reflect the distinctive nature of charities. The other-regarding behaviour promoted by charities is a key point of distinction to many member-serving NFPs.

One potential approach, that reflects the above two points, is to start with non-charity and non-government entity categories of income tax exempt organisations (under Div 50 ITAA97). Those organisations are largely implicitly or explicitly defined by reference to a purpose. Any conditions particular to those types of NFPs, but not necessarily of relevance to charities, could be carried across and applied only to the newly imported NFPs.

5. Regulatory Action to Enforce the ACNC Legislation

The ACNC cannot undertake most enforcement actions against charities that are not Federally Regulated Entities. In particular, charitable trusts and unincorporated associations are very unlikely to be constitutional corporations and may not be covered by the territories powers. Moreover, for perpetual charitable trusts there are unlikely to be many market mechanisms to control agency costs.

This poses problems if the ACNC is intended to be the primary regulator of charities and necessitates a focus on collaboration with other regulators, given the continued application of common law duties and other statutory duties.

In the short term, it is suggested that the ACNC be provided with funding to investigate the ACNC's ability to access enforcement mechanisms under other legislation or pursuant to the relevant Attorney-General's fiat. For example, can the ACNC seek a section 1323 *Corporations Act 2001* (Cth) injunction (assuming that directors' duties are switched back on for companies limited by guarantee that are registered with the ACNC)? Can the ACNC take relator action, or seek orders under the Queensland and Western Australian legislation for charitable trusts that provides relatively open standing?²²

6. Development of NFP and Charity Law

Unlike the United Kingdom, Australia has witnessed a number of recent charity law decisions by our highest court, or else senior appellate courts. Many of those decisions were due to test case funding (eg *FCT v Word Investments Ltd*,²³ *FCT v Hunger Project Australia*²⁴ and, it

²¹ *FCT v Co-op Bulk Handling Ltd* (2010) 189 FCR 322.

²² *Charitable Trusts Act 1962* (WA) s21(1); *Trusts Act 1973* (Qld) s106(1), (2).

²³ (2008) 236 CLR 204.

²⁴ (2014) 221 FCR 302.

appears, *Aid/Watch v FCT*²⁵). If charity law is to continue to develop then test case funding will be very material. It is all the more necessary in that as a result of the *Charities Act 2013* (Cth), Australia is diverging further from a number of other jurisdictions with which it has shared the common law meaning of charity for many hundreds of years.

The ACNC currently provides non-binding rulings in the form of administrative advice. To improve certainty, it is recommended that binding rulings ought to be available in the same way as they used to be available from the ATO on similar questions as to charity or public benevolent institution status. Some caution would be required about the duration of rulings, noting that tax rulings would typically have been for a number of income years for the relevant entity (when ruling about charity status) or about a particular transaction. However, this could be dealt with through the administrative practices adopted by the ACNC.

Further, if binding rulings are enabled, then de-identified forms of those private rulings ought also to be made public as the ATO does with the private binding rulings that it issues. This would improve public understanding of the way that the ACNC legislation is being administered.

Finally, it is suggested that consideration be given to funding for the ACNC to adopt an amicus curiae role so that it can make submissions in appropriate state and territory cases on charity status. The *Law Institute of Victoria* case provides a potential example.

7. The Importance of Regulating Purposes not Means

Recent charity law cases (such as *Word Investments Ltd*) have tended to emphasise that charities may adopt a very broad range of means to achieve an end, so long as that end is charitable and the means are not fundamentally harmful to society.²⁶ This focus on purposes, while leaving means to the discretion of charity controllers, helps preserve charity independence, which is consistent with the goals of the charity sector as discussed above.

Any reforms to the ACNC legislation should also respect this breadth and not involve micro-management of the merits of charity decisions about how to pursue purposes.

8. My Capacity

I make this submission in my capacity as an academic at the UWA Law School and not in my capacity as a member of the Law Council's Charities and Not-for-profits Subcommittee nor as a member of the Tax Institute's Not-for-profit Technical Committee. In addition, any views

²⁵ (2010) 241 CLR 539.

²⁶ See, eg, Ian Murray, 'The Taming of the Charitable Shrew: State Roll Back of Charity Tax Concessions' (2016) 27(1) *Public Law Review* 54.

expressed are mine and do not necessarily represent those of the University of Western Australia.