

28 February 2018

Mr Murry Crowe
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email ACNCReview@treasury.gov.au

Confidential

Dear Mr Crowe

**Submission on Public Consultation
Review of Australian Charities and Not-for-profits Commission (ACNC) legislation**

1 Introduction

- 1.1 Thank you for the opportunity to make a submission in response to the review of the Australian Charities and Not-for-profits Commission (**ACNC**) legislation.
- 1.2 Prolegis Lawyers is a legal practice established in 2001 that exists to provide assistance to charities and not-for-profits. All of our clients are either charities or individuals or businesses seeking to establish charitable or other not-for-profit entities. Although based in Sydney and Melbourne, our clients are located across all of the States and Territories in Australia and overseas.
- 1.3 Our experience and expertise working in the sector informs our comments on the practical operation of the ACNC legislation and our response to the questions raised in the Terms of Reference for the review dated 20 December 2017 (**TOR**).

2 Summary of our comments and recommendations

- 2.1 In summary, our comments and recommendations are as follows:
 - (a) The ACNC is a fit-for-purpose and effective regulator, and in this regard, we make the following specific comments:
 - (i) **Objects:** The ACNC objects are appropriate and relevant, and should be retained in their current form under the ACNC Act;
 - (ii) **Regulatory approach:** The ACNC regulatory approach, based on regulatory principles of necessity, reflecting risk and proportionate regulation, should be recognised and affirmed as central to the effectiveness of the ACNC and an approach to continue; and
 - (iii) **Red-tape reduction:** The ACNC has made significant headway in pushing to reduce unnecessary red-tape, and needs to be better resourced and empowered to continue these vitally important red-tape reduction efforts.

- (b) Given the effectiveness of the ACNC over the past five years, we recommend that the powers and remit of the ACNC be extended in the following areas:
- (i) **Protection of charitable assets and regulation of non-federally regulated entities:** Acknowledging the constitutional constraints, for many years, we have recommended that consideration be given to finding ways to enable the ACNC to take effective enforcement action to protect against wastage of charitable assets in relation to non-federally regulated entities and following deregistration of charities. One option already widely aired is the referral of state powers from the state Attorneys-General as the ‘protectors of charities’ to the ACNC, to enable the ACNC to commence charitable trust proceedings with the consent of state Attorneys-General. We also recommend consideration of the relevance of the obligations of the Australian Government under international human rights instruments to expand the regulatory scope of the ACNC in this regard.
 - (ii) **Regulation of other not-for-profits:** The regulatory remit of the ACNC should be extended, in a staged manner, to include other not-for-profit entities, as initially intended, such as specifically listed deductible gift recipients, and certain entities that self-assess as income tax exempt.
 - (iii) **External conduct standards:** The external conduct standards under the current ACNC regulations are yet to be enacted, and this should be progressed as a priority, and consistently with other existing codes of practice, to enable the ACNC to effectively regulate the external conduct of all registered charities.
- (c) While the framework is effective, we support technical amendments to refine and improve the ACNC Act as described below. However, we suggest that calls for reform to the ACNC Act need to be balanced against the uncertainty of tinkering with an effective framework in its infancy.

2.2 We elaborate further on each of these points below.

3 **Recommendation 1: The ACNC is a fit-for-purpose and effective regulator and its current objects and regulatory approach should be retained and continued.**

ACNC Objects

3.1 The TOR seeks comment on the following Question 1:

Are the objects of the ACNC still contemporary?’.

3.2 The objects of the ACNC are set out in section 15-5 of the ACNC and are as follows:

- (a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
- (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
- (c) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.

3.3 In response to the TOR Question 1, in our opinion, these objects are fit for purpose, continue to be relevant and should be retained in their current form.

- 3.4 We note that the ACNC's own submission to the Review has suggested the addition of the following further two objects:
- (a) To promote the effective use of the resources of not-for-profit entities; and
 - (b) To enhance the accountability of not-for-profit entities to donors, beneficiaries and the public.
- 3.5 We do not support this and would caution against any move to add such additional objects, as such a reform is both unnecessary and undesirable for the following reasons.
- (a) The role of a charity regulator is not to assess the effectiveness of charities, but rather to support the sector, maintain public trust and confidence, and take action in the public interest to protect against fraud and the misuse of charitable assets. It is a longstanding principle that courts and regulators should not interfere with the business judgment of those operating for-profit enterprises, and the same principle should apply to governing boards of charities in relation to the use of charity resources.
 - (b) Furthermore, it is unnecessary to add a further object of enhancing accountability. In administering the ACNC Governance Standards, which requires charities to be accountable to their members, the ACNC is actively promoting accountability as a necessary incident of furthering its existing object of maintaining, protecting and enhancing public trust and confidence in the not-for-profit sector.
- 3.6 We note that these two additional objects are copied from the objects of the Charity Commission for England and Wales. The legislative scheme in the ACNC Act is different from that in the UK, and these two objects do not fit. Also, the ACNC regulatory approach has been different from the beginning, and this is partly what has led to the success and wide support for the regulator in Australia. The past five years have demonstrated that Australia does not have a significant problem with "dodgy" charities that needs addressing, and so the ACNC's objects in their current form are appropriate without compromising the ACNC's good standing and credibility within the sector.

Preserving the ACNC Regulatory approach

- 3.7 The TOR seeks comment on the following Question 9:
- Has the ACNC legislation and efforts of the ACNC over the first five years struck the right balance between supporting charities to do the right thing and deterring or dealing with misconduct?*
- 3.8 In our experience, the ACNC has struck an effective balance in its first five years of operation in providing education and support for the diverse range of organisations it regulates, while also investigating and resolving complaints and dealing with compliance breaches.
- 3.9 In this regard, the effectiveness of the ACNC in administering the ACNC legislation, and the level of compliance by the sector and the broad support by the sector for the ACNC, may largely be attributed to this regulatory approach, based on regulatory principles of necessity, reflecting risk and proportionate regulation, and informed by the five key values of Fairness, Accountability and Transparency, Independence, Integrity and Respect.¹ In the context of the Australian not-for-profit sector, this has been an effective approach that

¹ See: ACNC Regulatory Approach Statement published on the ACNC website as at November 2015: https://www.acnc.gov.au/ACNC/About_ACNC/Regulatory_app/ACNC/Regulatory/Reg_approach.aspx?hkey=8251156f-f3c9-41bb-800a-304c2485be09.

should be recognised as central to the success of the ACNC and one that should be continued.

Empower the ACNC to continue its red tape reduction efforts

3.10 The TOR seeks comment on the following Question 8:

Has the ACNC legislation been successful in reducing any duplicative reporting burden on charities? What opportunities exist to further reduce regulatory burden?

3.11 One of the most significant selling points for having a federal regulator for charities when it was introduced five years ago was that it would provide the sector with a centralised body that can advocate on its behalf for red tape reduction, particularly in respect of the unnecessary and inconsistent requirements in the various states and territories. Prior to the ACNC, there was no such body to push for this much needed reform.

3.12 In its first five years, the ACNC has made significant headway in pushing to reduce unnecessary red tape and duplicative reporting requirements with its so-called 'charm offensive' - consulting with various departments and states and territories to promote the harmonisation and alignment of laws and processes that the charity sector has been vociferous in advocating for.

3.13 However, to be effective in undertaking this good and vital work, the ACNC needs to be better resourced and funded to continue these efforts, and particularly in relation to its efforts to:

- (a) harmonise and fix fundraising laws, with many charities still being required to navigate seven conflicting legislative regimes;
- (b) harmonise the definition of "charity" under Commonwealth, State and Territory legislation;
- (c) promote the adoption and use of ACNC charity passport by Commonwealth, State and Territory agencies so as to reduce the regulatory reporting burden on charities; and
- (d) advocate on behalf of the sector to reduce unnecessary regulation, particular in areas of law reform, for example, to reduce unintended consequences arising from electoral law reform.

4 Recommendation 2: Given the effectiveness of the ACNC, its remit should be extended to include the protection of charitable assets, external conduct and the wider not-for-profit sector.

4.1 Overall, the experience of the last five years suggest that Australia does not have a problem with 'dodgy' charities and that trust and confidence in the sector remains remarkable high.

4.2 However, for the reasons set out below, we are aware that there are gaps in the current regulatory framework that should be addressed relating to ACNC's powers to protect charitable assets and the ACNC's powers to regulate in respect of the external conduct of charities. We further suggest that the framework should be extended to include other not-for-profits.

- 4.3 In addressing these matters, this section addresses several of the questions raised in the TOR:

Question 2. Are there gaps in the current regulatory framework that prevent the objects of the Act being met?

Question 3. Should the regulatory framework be extended beyond just registered charities to cover other classes of not-for-profits?

Question 6. Have the risks of misconduct by charities and not-for-profits, or those that work with them, been appropriately addressed by the ACNC legislation and the establishment of the ACNC?

Question 7. Are the powers of the ACNC Commissioner the right powers to address the risk of misconduct by charities and not-for-profits, or those that work with them, so as to maintain the public's trust and confidence? Is greater transparency required and would additional powers be appropriate?

Protection of charitable assets

- 4.4 The ACNC legislation does not provide the ACNC with adequate enforcement powers in the event of misuse or “wastage” of charitable assets:
- (a) in circumstances where a charity is not a federally regulated entity (**FRE**) (and the ACNC therefore only has limited enforcement powers to deregister the entity); or
 - (b) if a charity revokes its charity registration (which may be triggered by a charity voluntarily cancelling its Australian Business Number), and the ACNC thereafter has no jurisdiction over the entity and cannot take any action to protect accumulated charitable assets.
- 4.5 This is a significant reform opportunity to address the absence of any viable remedy to protect against the misuse or wastage of charitable assets. Given this, we welcome and strongly support the first recommendation in the ACNC’s own submission, being:
- ‘Consider whether measures could be introduced at the Commonwealth level to protect a charity’s accumulated charitable income and assets after its ACNC registration has been revoked’.*
- 4.6 In this regard, for many years, we have been advocating for a delegation of power from the States and Territories of their powers exercised by the chief law officer (Attorney-General) to the Commonwealth. This could be done in a manner that would not oust the jurisdiction of the States and Territories, which could still have jurisdiction for cy-pres and administrative scheme applications, but would enable the ACNC to be more proactive in preserving charity assets, including the commencement of charitable trust proceedings. It seems unlikely to us that the States and Territories would go as far as referring this power. However, this is likely an optimal outcome. The ‘protector of charities’ role is an ancient and little understood responsibility, particularly by Attorneys-General in this and most other jurisdictions. In the UK this role has been delegated to the Charities Commission for England and Wales. We recommend consideration in this regard be given to the research being undertaken by Dr Oonagh Breen, University of Dublin, of the extent of the wastage and misuse of charity assets in like jurisdictions to Australia, and the ineffectual role of their protectors.
- 4.7 In addition, we recommend that the ACNC Review consider whether it would be feasible to extend its regulatory scope by either relying on the external affairs power under section 51(xxix) of the Constitution (the external affairs power), or the obligation of the Australian Government already under international law to implement in Australian domestic legislation the content of international human rights instruments to which Australia is a

signatory. To our knowledge this has not been explored, and could provide a further basis for regulation. A significant proportion of charities that are not FREs are covered by the rights to establish educational and other charitable and philanthropic institutions guaranteed by the *Declaration on the Elimination of All Forms of Intolerance and of Discrimination Based on Religion or Belief* (often referred to as the Religion Declaration, United Nations General Assembly A/RES/36/55 25 November 1981) extracts of which are included in the Appendix. The Religion Declaration is a relevant human rights instrument under the *Australian Human Rights Commission Act 1986* (Cth).

4.8 We also note that the external conduct standards (discussed below) are yet to be enacted, and will provide a broader basis for the ACNC to take regulatory action in respect of the external affairs of charities.

4.9 Further, measures to strengthen the ACNC's regulatory powers could include:

- (a) modifying the ACNC Act to include a requirement that registered charities must first obtain the ACNC's consent prior to changing its charitable objects if, by so doing, they would cease to be charitable; and/or
- (b) amending the *A New Tax System (Australian Business Number) Act 1999* (Cth) to prevent a registered charity from cancelling its ABN without the prior approval from the ACNC. This would close the current loophole whereby a charity may trigger the revocation of its charity registration, and therefore oust the ACNC's enforcement powers, by simply cancelling its ABN.

Enacting the external conduct standards

4.10 The external conduct standards are yet to be enacted under the ACNC regulations, notwithstanding that they were due to commence on 1 July 2013. These standards are intended to be principle-based minimum standards to regulate funds sent by registered charities outside Australia and the overseas activities of registered charities.

4.11 Importantly, once these external conduct standards are enacted, they will enliven the powers of the ACNC Commissioner (relying on the external affairs power) to take enforcement action in relation to the overseas activities of charities (including non-federally regulated entities) where there is a contravention of these standards, such as giving warnings and directions, seeking enforceable undertakings, seeking injunctions, or suspending or removing responsible persons.

4.12 It is our view, the failure to enact these standards to date has created a regulatory gap and resulted in inconsistent treatment, with some charities operating overseas being subject to comprehensive codes of conduct (such as under OAGDS Guidelines and ACFID code of Conduct), while other charities such as Public Benevolent Institutions only being subject to the ACNC Governance Standards.

4.13 Given this, steps should be taken to develop these external conduct standards as a priority, to enliven the regulatory powers of the ACNC and to ensure charities operating overseas are subject to a consistent standard. We suggest that the standards should be developed in a manner that is consistent with the principles underpinning the ACFID Code of Conduct and OAGDS Guidelines that have drawn on best practice from the overseas aid and development field, but modified and adapted so that they are proportionate for the range and types of registered charities undertaking overseas activities.

Extending the remit to not-for-profits

4.14 In our view, the public interest would be best served by extending ACNC's regulatory remit to include other not-for-profits, in line with the scope of the ACNC's current objects, so that the whole of the not-for-profit sector is subject to consistent governance requirements and regulatory oversight.

4.15 We acknowledge that the not-for-profit sector is diverse and significantly larger than the charity sector, and the ACNC needs further time to complete the work currently on its agenda, so this transition could be implemented in a staged fashion, starting with entities that claim similar tax concessions to charities, such as specifically listed deductible gift recipients, and by also undertaking a review of exempt entities under Division 50 of the Income Tax Assessment Act 1997 (Cth) to determine which entities may be suitable for inclusion of the ACNC register.

5 While the framework is effective, we support technical amendments to refine and improve the ACNC Act

5.1 In our experience, the ACNC has been remarkably effective and the ACNC legislation has worked reasonably well overall. Given this, we echo the sentiments of the ACNC Advisory Board Submission, on page 1, that the *'Act aint broke, question need to fix it'*.

5.2 In this light, while improvements and refinements could be made to the ACNC legislation, we suggest that the benefits of proposed reforms at this five year juncture should be balanced against the uncertainty and risks inherent in tinkering with a legislative framework that is working well overall and very much in its infancy.

5.3 We therefore make the following technical suggestions in this context, mindful that it may be helpful to address these matters in due course but they are not necessarily reform priorities for this 5 year review.

Duties on responsible persons – legal and fiduciary obligations

- (a) We note there has been some consternation regarding the extent to which the ACNC Act effectively imposes duties on 'responsible persons', given that:
 - (i) The ACNC Governance Standard 5 imposes a duty on the registered charity to 'take reasonable steps to ensure that its responsible entities are subject to, and comply with' particular duties, but does not impose such any equivalent duties on the responsible individuals themselves; and
 - (ii) certain directors duties under the *Corporations Act 2001* (Cth) (**Corporations Act**) have been 'switched off' for companies that are registered charities.
- (b) We acknowledge that this is a technical issue that may inhibit the ACNC from taking enforcement action against individual responsible persons, and that consideration should be given to addressing this in due course. For example, it would be worth considering whether it may be possible to address this by:
 - (i) modifying the ACNC Act to apply duties to responsible persons once constitutional limitations are addressed, such as after securing a referral of state powers; or
 - (ii) modifying the Corporations Act to switch back on directors duties, and having ASIC refer its powers to the ACNC.
- (c) Further, notwithstanding the limitations under the ACNC Act, we suggest that the ACNC legislation and/or guidance materials should explicitly acknowledge and articulate the underlying general legal and fiduciaries duties that apply at general law to persons governing charities, and to inform charities that these duties remain applicable. In our experience, there is little understanding in the sector of these underlying obligations.

- (d) The ACNC should make it clear that the governance standards do not replace these underlying common law duties, but rather, are designed to simply enliven the regulatory powers of the ACNC in much the same way as the duties of directors in the Corporations Act enliven the regulatory powers of ASIC in relation to directors.

Interaction of the ACNC Act with the Corporations Act

- (e) Section 111K of the Corporations Act ‘switches off’ a number of sections in the Corporations Act for companies that are registered charities. In our experience, many charitable companies have constitutions which continue to refer to and rely on the Corporations Act, particularly in relation to the rights of members and regulation of member meetings, and have not been updated to take into account that these provisions no longer apply to them.
- (f) One mechanism to address this issue would be to provide in the Corporations Act an interpretive provision for charitable companies, whereby the provisions in Part 2G.2 regarding the regulation of the meetings of members continues to apply to charities as a matter of default, but such provisions may be displaced or modified by the company’s constitution. This is similar to the approach taken in the Corporations Act with respect to replaceable rules under section 135.

Secrecy and enforcement

- (g) The ACNC is currently subject to strict secrecy laws which prevent it sharing and publishing its enforcement action and reasons for its registration decisions. The public interest would be better served if these matters could be made publically available in certain circumstances, and we support the recommendations in the ACNC’s own submission in this regard that would give the Commissioner the discretion to publish information where he or she considers that it would be in the public interest to do so (see recommendations 10, 11 and 12).

Charitable subtypes – PBI and HPC

- (h) The ACNC Act provides for the registration of charities with a corresponding subtype of entity, as set out in the table in section 25-5(5). These subtypes correspond to the charitable purposes listed under section 12 of the Charities Act 2013 (Cth), such as the subtype of ‘advancing health’, ‘advancing education’ and ‘advancing social or public welfare’.
- (i) However, the subtypes in the table also include that of ‘Health Promotion Charity’ (**HPC**) and ‘Public Benevolent Institution’ (**PBI**). In our view, the inclusion of these two subtypes in the same table creates confusion, and is a category error, as a HPC and PBI are not charitable purposes under the Charities Act, but rather are particular types of institutions developed for the purpose of taxation laws.
- (j) For this reason, we recommend removing the subtype categories of HPC and PBI from the table in section 25-5(5), and dealing with them in a separate sub-section in the Act. This would allow a charity to register as HPC or PBI, in addition to registering for the particular subtypes that corresponds to its charitable purposes, such as, for example, advancing social or public welfare, advancing education and/or advancing health.

Related party transactions

- (k) Chapter 2E of the Corporations Act applies to public companies, other than companies that are not required to have ‘Limited’ at the end of its name under section 150 or 151 of the Corporations Act. This means that any public company that is registered as a charity and remunerates its directors is subject to the related

party provisions in chapter 2E. In our experience this is not widely understood within the sector.

- (l) The purpose of chapter 2E is to protect the interests of a public company's members as a whole, by requiring member approval for the giving of financial benefits to related parties that could endanger those interests.²
- (m) Arguably, the protections that chapter 2E affords to members are not appropriate nor necessary for charities, which are subject to constitutional constraints, specifically, that the income and revenue of a charity may only be applied in furtherance of its charitable objects. These constitutional constraints protect against the diminution of the assets of a charity, and the members as a whole do not have an interest in those assets, except to ensure compliance with the constitution. Given this, we suggest that section 111 of the Corporations Act be amended to 'switch off' chapter 2E in relation to registered charities.
- (n) If Chapter 2E is retained as a measure to enhance the financial accountability for the class of registered charities to which is presently applies (i.e. those that are required to have 'Limited' at the end of their name) the present drafting in Chapter 2E should be reviewed to clarify its application to those registered charities, including in the following respects:
 - (i) Section 209(1)(a) – to clarify that the contravention of Chapter 2E may not affect the validity of a transaction but that breach of the company's constitution may affect validity;
 - (ii) Section 214 – to define or broaden the concept of a 'nominee' in the definition of a closely held subsidiary. This needs to be clarified as a common charitable structure is for directors of a charity to also be some or all of its members, and it is not clear that they do so as a 'nominee' in every case;
 - (iii) Division 3 – identify who is the appropriate regulator (ACNC or ASIC) for the lodging of material to be put to members (as required under section 218) and for commenting on proposed member resolutions (under section 220),

6 Concluding Comments

We would be pleased to discuss our submission with you in more detail. Please contact Anne Robinson on 02 9466 5222 should you have any questions or wish to discuss further.

Yours faithfully
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² See Corporations Act, section 207.

Appendix

United Nations General Assembly A/RES/36/55 25 November 1981

Declaration on the Elimination of All Forms of Intolerance and of Discrimination Based on Religion or Belief

Extract with our emphasis in **bold**.

Article 5

1. The parents or, as the case may be, the legal guardians of the child have the right to organize the life within the family in accordance with their religion or belief and bearing in mind the moral education in which they believe the child should be brought up.
2. **Every child shall enjoy the right to have access to education in the matter of religion or belief in accordance with the wishes of his parents or, as the case may be, legal guardians, and shall not be compelled to receive teaching on religion or belief against the wishes of his parents or legal guardians, the best interests of the child being the guiding principle...**

Article 6

In accordance with article 1 of the present Declaration, and subject to the provisions of article 1, paragraph 3, **the right to freedom of thought, conscience, religion or belief shall include, inter alia, the following freedoms:**

- (a) To worship or assemble in connexion with a religion or belief, and to establish and maintain places for these purposes;
- (b) To establish and maintain appropriate **charitable or humanitarian institutions;**
- (c) To make, acquire and use to an adequate extent the necessary articles and materials related to the rites or customs of a religion or belief;
- (d) To write, issue and disseminate relevant publications in these areas;
- (e) To teach a religion or belief in places suitable for these purposes;
- (f) To solicit and receive voluntary financial and other contributions from individuals and institutions;
- (g) To train, appoint, elect or designate by succession appropriate leaders called for by the requirements and standards of any religion or belief;
- (h) To observe days of rest and to celebrate holidays and ceremonies in accordance with the precepts of one's religion or belief;
- (i) To establish and maintain communications with individuals and communities in matters of religion and belief at the national and international levels.

Article 7

The rights and freedoms set forth in the present Declaration shall be accorded in national legislation in such a manner that everyone shall be able to avail himself of such rights and freedoms in practice.