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Manager
Philanthropy and Exemptions Unit
Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: NFPReform@treasury.gov.au

Dear Treasury

**Exposure draft: Restating and standardising
the special conditions for tax concession entities
(including the 'in Australia' conditions)**

CSA is the peak body for over 7,000 governance and risk professionals. It is the leading independent authority on best practice in board and organisational governance and risk management. Our accredited and internationally recognised education and training offerings are focused on giving governance and risk practitioners the skills they need to improve their organisations' performance and are 'first-choice' options for those intent on pursuing a C-suite career. CSA has unrivalled depth and expertise as an independent influencer and commentator on governance and risk management thinking and behaviour in Australia.

Our members are all involved in governance, corporate administration and compliance with the *Corporations Act* (the Act). Many of our members serve as officers of not-for-profit (NFP) organisations, or work for or are involved with companies limited by guarantee. CSA itself is a company limited by guarantee, formed to serve the interests of its Members, who are governance professionals.

CSA welcomes the opportunity to comment on the Exposure draft: Restating and standardising the special conditions for tax concession entities (including the 'in Australia' conditions) (the exposure draft) and draws upon the experience of our Members in formulating our response.

Coordination of the NFP consultation process

CSA holds concerns about the fragmented and disjointed manner in which the NFP reform process has been undertaken. CSA notes that despite the reform agenda having been underway for over 12 months, there is still no regulatory reform plan that clarifies how the reform processes will align. It is also difficult for stakeholders to ascertain the degree of coordination between the three separate organisations involved in the reform process; that is the Australian Charities and Not-for-profits Commission (ACNC), the Treasury, and the Australian Taxation Office (ATO).

The current exposure draft provides further evidence of the seemingly disconnected stream of consultations about discrete areas of NFP reform which, in many cases, have consequences that are not in accordance with the intended aim of NFP reform. It appears that the current exposure draft has been drafted in isolation from the rest of the reform agenda, and appears to be inconsistent with the aims of the NFP reform program, which are to reduce the compliance

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burden on NFP organisations and provide a light-touch, principles-based approach to the regulatory framework.

For example, CSA notes the content of the ACNC Implementation Design discussion paper (the discussion paper) which states that: ‘...overwhelmingly most (charities) aim to comply with their regulatory requirements’.¹ The discussion paper notes further that the role of the ACNC will be to offer guidance and general advice to charities to assist them to meet their obligations; and where there is evidence of non-compliance the ACNC will use graduated powers and provide opportunities for self-correction. The discussion paper makes clear that a fundamental role of the ACNC is to provide such education and assistance, with its enforcement capacity being an additional part of its *raison d’être*, rather than its primary purpose.

No such latitude exists in the provisions of the ‘in Australia’ drafting in the exposure draft, with the legislation adopting an extremely heavy handed approach to regulation that enforces compliance through the removal of the tax exemption status for charities that do not comply.

CSA is of the view that the integrity issues raised in the exposure draft might be satisfied by establishing the ACNC, which in turn will register charities and require them to report on their income and expenditure. The disclosure obligations which are the subject of other consultations, such as governance arrangements and the exposure draft of the ACNC legislation will provide the information necessary to ascertain how funds are expended. Further, CSA recognises that there are also a multitude of current laws across all sectors which allow for the investigation and prosecution of organisations who fund overseas entities involved in criminal enterprise or terrorist activities.

CSA believes that the intention of the exposure draft is misaligned with the overall reform agenda, which is to reduce red tape and streamline the compliance burden. CSA notes that there have been relatively few indiscretions that have occurred in this area, and that the exposure draft places a relatively high and unfair compliance burden on NFPs by asking them to trace the use of funds by external organisations. Further, the exposure draft makes no allowance for the internal resourcing and system changes that will need to be put in place to ensure that NFPs are able to meet these new compliance obligations.

The new regulatory body, the ACNC, has as its major task the simplification of the regulation and reporting requirements of NFP organisations. Particular emphasis is placed on good governance practice, compatible with ensuring that scarce resources are efficiently and effectively utilised for the official objectives of NFP organisations. The taxation measure proposed in the consultation paper, which is probably designed to capture a small number of NFPs, is going to undermine the new NFP initiative by placing significant administrative burdens on all NFPs, including small NFPs which often lack the technical skills to handle complex administrative matters.

Therefore, **CSA strongly recommends** that the government postpone any changes to the taxation arrangements of NFPs and not undermine the potential of the ACNC to provide a holistic regulatory framework for the NFP sector.

The focus of the NFP reform agenda should be on the establishment of the ACNC, with a regulatory reform plan provided to stakeholders showing a clear picture of how the specific reform consultations align. CSA notes that the lack of strategic coordination has presented a piecemeal approach to the reform process which hinders clarity as to how the reform proposals will achieve the objective of reducing and streamlining the compliance burden for the NFP sector.

¹ Australian Government Treasury 2011, ‘The Australian Charities and Not-for-Profits Commission Discussion paper’ Downloaded on 9 December 2011 from <http://acnctaskforce.treasury.gov.au/content/Content.aspx?doc=communityengagement/discussionpapers/functionsandops.aspx>; at pg 5

Lack of clarity in the operation of the 'in Australia' provisions

As noted above, CSA has concerns about the operation of the 'in Australia' special conditions contained in the exposure draft. CSA understands that the special conditions predominantly apply in situations where an entity may give money or property (to further its purpose) to another entity that is not entitled to tax exemption status. Under the new special conditions proposed in the exposure draft, the use of the funds received by the other entity should now be taken into account when determining whether or not the entity giving the money has met the 'in Australia' special condition.

In the first instance, CSA is concerned that the wording of the exposure draft provides little clarity as to the extent to which an entity is required to investigate and/or trace the 'use of money' by a recipient. Section 50-50: Special conditions for certain items and section 30-18 Fund, authority or institution must operate in Australia etc... provide only that an entity which gives money or property to another entity which is not an exempt entity is required to take into account the use of the money 'by the recipient (or any other entity)' when determining if they are continuing to operate within the 'in Australia' provisions. CSA notes that the phrasing of the responsibility is indeterminate and broad. NFPs who wish to continue to donate funds to third party entities that appear to satisfy the 'in Australia' conditions, have no safeguards to provide them with reassurance that they have undertaken reasonable efforts to comply with the 'in Australia' provisions.

Instead, NFPs will now need to delve into the operations of third-party entities to determine how the recipient is using the donation; how many other organisations might receive some of the funds provided to the recipient; and how the donating entity can guarantee that they have complied with the legislative requirement. CSA is concerned that the current drafting is a broad catch-all provision which will be extremely difficult for NFPs to implement and burdensome for the very many smaller NFPs who do not have the resources to undertake a due diligence practice at the level being sought. In some instances, CSA notes that NFP entities will now be required to undertake due diligence processes at levels which go beyond those required in areas of for-profit operation.

Further, CSA notes that NFPs will bear the administrative and advice costs associated with undertaking these due diligence processes. In turn, this is likely to distract from the fulfilment their core altruistic purpose. NFPs who continue to donate funds to recipients who are apparently undertaking activities consistent with their objectives will now be required to set up the systems involved in undertaking due diligence or otherwise employ or contract advisers to assist with this process. CSA recognises that medium and large tax exempt entities may also be disadvantaged by these provisions, as the extent to which they will be liable for the actions of other entities remains unclear.

The alternative is that some NFPs might choose to simply discontinue donating funds to recipients in light of the risk that this action now carries. As a result, other smaller charities or NFPs may no longer receive donations on which they might usually rely.

CSA believes that neither outcome is desirable. NFPs must be offered both certainty in their processes and clear guidance as to how this provision can be practically implemented. To this end, **CSA recommends** that the exposure draft include a further due diligence 'defence' requirement, which spells out that the Tax Commissioner will not revoke the tax exempt status for an NFP where the NFP had no reason to suspect that their donation would be used for anything other than the intended purpose.

CSA believes that a tax exempt entity which provides funds to a recipient, and can show that they have obtained information about the intended purpose of the funding, for example through a negotiated contract, should be taken to have met the due diligence 'defence' requirement regardless of the actual further use or misappropriation of the funds by the recipient. Naturally where good faith does not exist, the contract would not provide a defence.

CSA would welcome the opportunity to discuss any of our views in greater detail.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style with a large initial 'T' and a long, sweeping underline.

Tim Sheehy
CHIEF EXECUTIVE