NEWSLETTER

cornwallstodart
ENHANCING SUCCESS

Not for Profit Team Newsletter

September 2016

Cornwall Stodart has a significant and proud history of representing and providing legal and commercial advice to not-for-profit organisations including religious orders, sporting clubs and associations, schools and higher education institutions, and public benevolent institutions. Cornwall Stodart is also emerging as a pre-eminent impact investing and social finance legal firm in Australia.

The 'for purpose' sector in 2016 is a dynamic industry. Important changes have occurred in the legal environment with the introduction of a purpose-specific regulator, the Australian Charities and Not-for-profits Commission (**ACNC**) and the partial codification of the common law in the *Charities Act 2013* (Cth). Alongside these legal changes, the persistent contraction in fundraising revenue generated by donations has reduced operating budgets and, at the same time, created opportunities for organisations to innovate and adapt, and seek more productive and sustainable revenue streams.

Each edition of this newsletter will aim to inform and inspire you by:

- updating you on fundamental changes to the legal environment; and
- providing industry insights and thought leadership to support the continued growth of financially resilient and impactful 'for purpose' organisations.

This September edition includes news on the following:

- The latest word from the ACNC: what's happening from the regulator's perspective?
- Alternative funding models: the move away from fixed income grants and donations, and towards sustainable operations.
- Review of state-based tax exemptions available to charities: an opportunity to audit payment history and seek refunds.
- Transferring money offshore: recent developments in legal and administrative frameworks.

We have also included a short profile on Impact Investing Australia for those who are interesting in learning more about the industry-specific leadership body.

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The latest word from the ACNC: what's happening from the regulator's perspective?

Legal status

On 4 March 2016, the government announced the withdrawal of the Australian Charities and Not-for-profits Commission (Repeal) (No. 1) Bill 2014 (**Bill**). The motion to withdraw the Bill (which was carried unanimously by the Senate) signalled to the ACNC that it's here to stay – at least until the mandated review of the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) in December 2017.

The ACNC has confirmed it will continue to focus on its core objects, being:

- red tape reduction initiatives (eg a common definition of 'charity' in state taxation legislation, sector-specific accounting standards);
- maximising the integrity of the ACNC Register and creating IT infrastructure to deliver reliable data insights; and
- taking enforcement action against unlawful operators (eg breaches of record-keeping, management of financial affairs, duties to act in good faith and with care and diligence).

Activities

Ask ACNC

The ACNC will be continuing its popular 'Ask ACNC' roadshows in September 2016. The sessions provide basic financial training and attendance is free. Locations and dates can be viewed at acnc.gov.au.

Commissioner's Interpretation Statement

The ACNC has also released a Commissioner's Interpretation Statement regarding the High Court decision in The Hunger Project Case (which clarified the legal meaning of a 'public benevolent institution' (**PBI**)) (**Interpretation Statement**). A copy of the Interpretation Statement is available at acnc.gov.au. The ACNC is the only body currently empowered to endorse an organisation as a PBI. Accordingly, the Interpretation Statement will take precedence over the ATO's Taxation Ruling TR 2003/5 (which has not yet been formally withdrawn) (**ATO Ruling**).

In general, the Interpretation Statement sets out a legal test for determining a PBI that is broader than the test set out in the ATO Ruling, with the exception of the 'activity test'. The 'activity test' as set out in the Interpretation Statement requires organisations to demonstrate a 'workable plan' to achieve the organisation's goals prior to obtaining PBI endorsement, in order to ensure appropriate oversight across the flow of funds – including to offshore locations. This may lead to a circumstance where an organisation is unable to achieve PBI endorsement without first obtaining funding, but is concurrently unable to secure funding without PBI endorsement. It will be important for newly established organisations seeking endorsement to have well-developed governance, funding and operational plans, and to consider early/proactive engagement with the ACNC.

Data sets

The ACNC has encouraged people undertaking research in the sector to utilise the data sets derived from the ACNC Register and Annual Information Statements available at data.gov.au. The data available includes information arising from the 2013 and 2015 qualitative studies into public trust and confidence in Australian charities.

Cash reserves

The ACNC is preparing guidance on the maintenance of cash reserves (between 25% to 50% of annual revenue) to promote financial sustainability and help organisations withstand significant and unanticipated reductions to fundraising revenue (eg as a result of a scandal, adverse economic conditions etc). The ACNC has stated that it will engage with statutory funders to ensure they are aware that maintaining a surplus is recommended practice and to encourage them not to overlook organisations for grants on the basis of a cash surplus.

Industry observations

The ACNC has also recently made the following observations:

- there is a renewed emphasis on encouraging good governance within the sector as a result of the recent investigations by the Royal Commission into Institutional Responses to Child Sexual Abuse;
- it is monitoring the use of digitally disruptive technologies, including charity-rating websites (eg CareNavigator.com.au) and crowd-funding websites; and
- collaboration has increased among organisations in response to funding pressures, evidenced by shares back-office service and M&A activity.

Reporting obligations

The ACNC has clarified when an organisation is required to contact the ACNC and/or ASIC regarding changes to charities that are structured as companies limited by guarantee.

Notifiable event	ACNC	ASIC
Change of company name (including to omit the word 'Limited')	Yes	Yes
Changes to address for service, directors and constitution	Yes	No
Resignation or removal of auditor	No	Yes
Deregistration	Yes	Yes

Comment

Operators in the sector should stay up-to-date and informed on the activities and objectives of the ACNC: these will continue to affect PBIs and will provide necessary guidance on a variety of issues. Please contact us if you have any queries or concerns.

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Alternative funding models: the move away from fixed income grants and donations, and towards sustainable operations

Charities and not-for-profits have traditionally raised more than half of their operating income from self-generating sources (eg fee for service activities, investment income). That trend is set to continue with the revenue derived from donations and bequests typically dropping to less than seven per cent of an organisation's total revenue. The recent increase in the number of charities adopting impact investment as a tool to give effect to carefully constructed – but equally bold – strategic plans has been unquestionable. 'For purpose' organisations are steadily moving away from operating their cash flow and finances on a hand-to-mouth basis, and are instead focusing on redesigning their funding models to create longevity and financial sustainability.

What is impact investing?

Impact investing is the process of using the economic tools of a capitalist system to generate a return on investment that comprises both a financial return and a social return or 'impact'. As Lawrence Summers, former US Treasury Secretary said (after investing in a United States social impact bond in May 2014): 'This is ground zero of a big deal'.

Impact investing often involves investment in a 'social enterprise', being organisations that derive a substantial portion of their income from trade and use that income to pursue a mission that generates a public or community benefit (eg STREAT, which supports homeless youth by providing them with employment and skill-acquisition opportunities, and the Australian Chamber Orchestra Instrument Fund, which purchases expensive stringed instruments that are expected to appreciate in value over time and are in the interim lent to members of the Australian Chamber Orchestra).

In the course of our impact investing and social finance practice, we see strong dividends being derived when charities, governments and corporate bodies collaborate to meet social and economic demands within a shared value framework.

Precipitating factors

The context within which impact investment arises is important: it is a revenue-generating tool that typically forms part of a broader, multidimensional strategic directive. We are seeing organisations embark on a period of introspection, during which they grapple with many questions including:

- 'What is our purpose for existing and are our activities actually pursuing that purpose?'
- 'Are our operations spread too thin and can we reorganise our activities to focus on our unique skills and expertise?'
- 'Are we still an organisation that is relevant to our supporters and the communities we serve?'
- 'How can we enhance our effectiveness and ensure that we rapidly become irrelevant because the need we serve has been satisfied?'
- 'Has the evolution of technology and communication platforms necessitated an evolution of our theory of change, or can we fulfil a different role to support our theory of change?'
- 'Are our activities better carried out by another organisation?'
- 'Are we effective in engaging our staff and volunteers?'
- 'How are we going to remain agile to address new challenges arising over the next 20 years?'

This process of challenging the fundamental principles of the organisation can often lead to an invigorated focus on core value propositions and/or exploitation of new opportunities that were previously unidentified or untapped.

Conclusion

Impact investment is a developing trend in Australia's capital markets that is the product of both 'head and heart' decisions. We suggest organisations familiarise themselves with the tenets of impact investing to determine whether it is a tool that may be useful in the pursuit of their missions and ensure they are appropriately equipped to engage with the next phase of charity evolution in Australia.

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Review of state-based tax exemptions: an opportunity to audit payment history and seek refunds

The practical issue

Income tax exemption (granted by the federal government) is commonly the focus of tax concession endorsement sought by charities and not-for-profits. However, various significant tax concessions are granted by the states, including:

- transfer duty exemption;
- payroll tax exemption; and
- land tax exemption.

A series of legislative changes in 2015 in Western Australia, the Northern Territory, South Australia and the Australian Capital Territory have tightened up the criteria for the state-based tax concessions in those regions, in response to what was perceived as an expansion of the criteria as a result of developments in case law. Accordingly, now is an opportune time for charities and not-for-profits operating in Victoria, New South Wales, Queensland and Tasmania to examine their payment position in respect of transfer duty, payroll tax and land tax to determine whether their organisation may be entitled to claim an exemption and seek a refund of any amounts previously remitted.

The legal issue

In 2013 the federal government adopted a legislative definition of the word 'charity', which is set out in the *Charities Act 2013* (Cth). None of the states have amended their tax legislation to incorporate the new Commonwealth legislative definition of 'charity'. Accordingly, the definition of the word 'charity' for the purpose of state-based tax concessions is governed by non-uniform state legislation and the common law that prevails in each applicable state.

In broad terms, according to the common law an entity is charitable if its purposes and activities:

- fall within one of the four 'heads of charity' (ie relief of poverty, advancement of religion, advancement of education and other purposes beneficial to the community); and

- provide a public benefit.

It is point 1 above that has been the subject of judicial decisions that have been perceived as broadening the scope of the type of entity entitled to apply for state-based tax concessions – and the subsequent legislative narrowing of that scope.

What do you need to look out for?

The criteria for applying the state-based tax concessions vary from state to state. However, they typically require an examination of an entity's purposes and activities. Below is a list of some of the key practice points to be aware of:

Transfer duty

- In Queensland, the property that is the subject of the transfer must be used by a 'charitable institution' for a 'qualifying exempt purpose' (which is defined in section 415 of the *Duties Act 2001* (Qld)) for at least one year, beginning within six months of the transaction. This requirement can be problematic where the property in question is vacant land.

- In New South Wales, a property used by a religious institution may not be eligible for transfer duty exemption.

- The position in Victoria is relatively relaxed: the property in issue must simply either be transferred or held on trust for 'religious, charitable or educational purposes' (as determined according to the common law).

- Transfers of property in Tasmania are only exempt if they involve no consideration changing hands and are solely for furthering religious, charitable or educational purposes.

- In South Australia and the Northern Territory, the legislatures have expressly excluded properties used for commercial or business purposes from the exemptions (in response to the High Court's decision in *Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55 (**Word Investments Case**)).

Land tax

- In Victoria, land that is <u>used</u> by a charitable institution solely for charitable purposes will be exempt from land tax (ie there is no requirement for the land to be <u>owned</u> by the charitable institution).

- It is anticipated that Queensland may take steps to tighten its legislation to prevent an exemption being obtained in respect of property used for commercial purposes.

Payroll tax

- Payroll tax exemption is typically available in New South Wales, Victoria, Tasmania and South Australia in respect of wages that are paid in connection with 'religious, charitable, benevolent, philanthropic or patriotic' purposes.

Summary

The criteria for state-based tax concessions differ among the various jurisdictions. However, organisations that have paid or are paying transfer duty, land tax and/or payroll tax should consider whether they may be entitled to a refund(s). This is particularly important where an exemption has been refused previously or not sought on the basis that an organisation's commercial activities prevented it from being deemed to have been pursuing its charitable objects (ie, the legal position prior to the Word Investments Case).

Organisations that currently rely on the Word Investments Case to claim state-based tax concessions should be cognisant of the potential for states to:

- legislate to close the perceived expansion of the exemption criteria as a result of that decision; and/or

- adopt the Commonwealth definition of 'charity', which is subject to certain express exclusions (eg business activities).

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Transferring money offshore: recent developments in legal and administrative frameworks

The ATO has, through its administration of the law, historically sought to restrict the flow of funds being sent overseas due to a concern that those funds would be misused. Until recently, the main way to send deductible funds (ie money derived from donations) offshore was to use an Overseas Aid Gift Deductible Scheme. However, a series of recent common law and administrative changes – and proposed legislative amendments – appear to be removing some of the major barriers preventing organisations from sending money overseas. These changes include:

- The decision in *Commissioner of Taxation v Hunger Project Australia* [2014] FCAFC 69 (**The Hunger Project Case**) (which held that an organisation could send the majority of its deductible funds to overseas charities engaged in the relief of poverty, illness and misfortune – and still be entitled to be endorsed as a public benevolent institution).

- The release of the Commissioner's Interpretation Statement: The Hunger Project Case (CIS 2013/01).

- The review (and likely withdrawal) of the ATO's Taxation Ruling TR 2003/5 regarding public benevolent institutions.

- The shelving of proposed amendments to the 'in Australia' special conditions in the *Income Tax Assessment Act 1997* (Cth) (**ITAA1997**).

The Hunger Project Case

Links to our previous articles regarding The Hunger Project Case are available at cornwalls.com.au and informit.com.au.

'In Australia' proposed amendments

Context

Treasury has for many years sought to close perceived 'loopholes' that permit deductible funds to be used for charitable projects situated overseas. One 'loophole' it sought to close was the interpretation of the 'in Australia' Division 50 Special Condition.

Section 50-47 of the ITAA1997 requires an entity to have 'a physical presence in Australia, and to that extent incur its expenditure and pursue its objectives principally in Australia'. The Commissioner had interpreted this Special Condition as requiring an entity to pursue its purposes (ie undertake its charitable activities) principally in Australia for the benefit of the Australian community, and sought legislative amendments to give effect to this interpretation. What followed was the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (Cth), which was subsequently withdrawn by government after strong criticism by the sector.

Update

The government, at least for the time being, is no longer seeking to restrict income tax exemption and DGR endorsement to only those entities that carry out charitable activities principally in Australia. Accordingly, an opportunity exists for charities undertaking benevolent activities offshore to seek registration as a public benevolent institution (and endorsement for income tax exemption and DGR status), rather than undertake the comparatively onerous process associated with becoming an approved Overseas Aid Gift Deduction Scheme organisation.

While charities undertaking charitable work offshore have more options available to them to obtain tax concession endorsements as a result of the recent developments, some entities (particularly those that do not deliver hands-on aid and/or have a development or preventative focus) may still prefer to become an approved organisation under the Overseas Aid Gift Deduction Scheme.

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Profile – Impact Investing Australia

Impact Investing Australia (IIA) is an independent organisation dedicated to growing the opportunities for investments that deliver positive social and environmental impact alongside a financial return. Its vision is for a healthy, equitable and prosperous Australia, supported by a dynamic market for impact investing that expands opportunities and creates innovative solutions to pressing societal challenges. IIA was established in 2014 in response to an industry-identified need for dedicated leadership, facilitation and capacity building. From social enterprises and not-for-profit organisations in need of capital, to investors wanting to achieve social impact, IIA provides a focal point for market development in Australia and participates in efforts to grow the global market for impact investing.

What are the benefits of impact investing?

Impact investing demonstrates that it is possible to 'do well' at the same time as 'doing good', dispelling the notion that investing for profit and giving money to charitable work must be separate activities.

By creating new opportunities for investors to make money, as well as address social or environmental issues, impact investing expands the pool of capital available for financing initiatives and organisations with a social purpose. The market for impact investing is expected to reach $32 billion in Australia – and US$500 billion to $1 trillion globally – over the next decade.

Impact investing benefits people and communities in many ways:

- Socially motivated entrepreneurs and organisations gain access to finance and support, helping them grow their businesses and have greater impact
- Communities benefit when they can fund new opportunities to develop services and infrastructure, as well as generate jobs
- Investors have greater choice and new opportunities to put their money to use in ways that make a financial return and also benefit society
- Philanthropists benefit with options to generate more impact through their activities
- Governments achieve better outcomes and greater flexibility to target spending and encourage more private capital into areas where there is a need for new solutions
- Institutional investors have more options for diversifying their portfolios and fulfilling their duties as fiduciaries
- Mainstream financial markets benefit from access to finance for initiatives and services that create positive impact in the community

Impact Investing Australia's role

Momentum is building. There are already many examples of successful impact investments in Australia and the challenge now is to build on these foundations of leadership, innovation and diversity. As such, IIA is heavily invested in developing infrastructure for this market, growing participation among stakeholders and influencing policy. IIA incubates and builds initiatives that have been identified as critical to accelerating the growth of impact investing. A prime example is the Impact Investment Readiness Fund (Fund). In March 2015, IIA launched the Fund in partnership with and seeded by NAB. The Fund provides grants of up to $100,000 to provide mission-driven organisations with targeted advice and support to help them secure investment for scaling up their social or environmental impact.

IIA also provides opportunities and resources for people to learn about impact investing and translate their interest into action. It has a growing library of case studies and impact profiles, and publishes a regular newsletter with news, events and market roundups. IIA has also authored the Impact Investing Australia 2016 Investor Report, which makes an important contribution to understanding how the demand for impact investing is shaping in Australia. Through partnering with other organisations, IIA helps deliver the annual Impact Investment Summit Asia Pacific – bringing together over 200 investors and other stakeholders with an interest in impact investing. It also convenes roundtables that bring together groups for collaborative learning, policy discussions or transactions.

For further information about IIA's activities or to find out more about how IIA could potentially help your organisation achieve its purposes, visit IIA's website at www.impactinvestingaustralia.com.

Follow Impact Investing Australia on Twitter @ImpactInvAus for up-to-date developments on the impact investing ecosystem.

Should you have any queries in relation to this newsletter, please contact:

Michael Kohn
Partner
Phone (direct) +61 3 9608 2160
Email m.kohn@cornwalls.com.au

Meng Lee
Senior Associate
Phone (direct) +61 3 9608 2157
Email m.lee@cornwalls.com.au

Lesley Naik
Associate
Phone (direct) +61 3 9608 2179
Email l.naik@cornwalls.com.au