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# May 2011 Budget Changes Affecting Australia's Not-for-profit Sector

## Background

Australia's not-for-profit (**NFP**) sector plays a key role in promoting the social, cultural, economic and environmental interests of all Australians. The sector consists of approximately 600,000 entities and contributes over $43 billion to the economy. It is larger than the communications industry, agriculture or tourism[1]. Accordingly, it is vital that the sector is both supported to further its altruistic objectives and regulated to protect against attempts to take advantage of this support.

The May Budget of 2011 proposed numerous reforms to the sector aimed at reducing red tape, increasing compliance, improving transparency and accountability and strengthening the sector, and included other measures to assist various programs operated by NFPs (refer to Appendix 1). Broadly, the Budget reforms stipulated[2]:

1. establishment of an independent Commonwealth Regulator for the sector: the Australian Charities and Not-for-profits Commission (**ACNC**);
2. codification of a definition of charity for all commonwealth law purposes; and
3. tightening of tax concession for charities undertaking unrelated commercial activities.

It has been suggested that the triggers for these reforms were demands by the business sector to provide a level playing field regarding taxation benefits – that is, competitive neutrality and the arguable questionability of some of the commercial activities being undertaken by NFPs (eg poker machines, service of alcohol)[3]. Against the backdrop of the Global Financial Crisis, the government's concerns about fiscal deficits and the 'integrity' of the tax base are

1 Australian Government Productivity Commission Research Report, *Contribution of the Not-for-profit Sector,* January 2010 http://www.notforprofit.gov.au/about-us/about-us-page-1

2 Australian Government, *Budget Measures to Strengthen the Not-for-profit Sector* http://www.notforprofit.gov.au/sites/default/files/files/Not-for-Profit%20Sector%20 Guide%20to%20the%20Budget%202011-12.pdf

3 Annette Morgan and Professor Dale Pinto, 'The current state of play relating to not-for-profit tax concessions in Australia and a glimpse of what may lie ahead for these concessions'

also likely to be influential factors[4].

This discussion paper addresses the areas of proposed reform that are likely to have the most impact on the NFP sector; namely, points 1, 2 and 3 above.

It is important that organisations are aware of the concessions available to them and how the proposed reforms will impact the availability of those concessions.

This paper also outlines how the coexistence of current corporations legislation regulating certain NFPs and the requirements under the new ACNC legislation may give rise to potential duplication of governance and reporting standards for NFPs.

4 Kerri Sadiq and Catherine Richardson, 'Tax Concessions for Charities: Competitive Neutrality, the Tax Base and "Public Goods" Choice' (2011) 25 *Australian Tax Forum 597*

## Australian Charities and Not-for-profits Commission (ACNC)

While the implementation of legislation relating to the tightening of tax concessions has been delayed, the ACNC Bill was passed by the commonwealth parliament on 1 November 2012, and the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (**ACNC Act**) and the *Australian Charities and Not-for-profits Commission (Consequential and Transitional) Act 2012* (Cth) (**ACNC Consequential and Transitional Act**) are now in operation.

The ACNC, which commenced on 3 December 2012, is now the independent national regulator of charities and is projected to eventually be the regulator of all NFPs in Australia. It is anticipated that with ASIC's regulatory role for these entities likely to be displaced, two separate but parallel systems of company regulation will remain – the determining factor being a company's tax status.[5]

The ACNC's responsibilities will include determining charitable, public benevolent institution and other NFP status of organisations, maintaining the Australian Charities and Not-for-profits Register, and implementing a more streamlined reporting framework.[6] The ACNC will also liaise with state and territory departments to reduce any overlapping reporting and disclosure obligations.

While ACNC registration is voluntary, certain entities would have been automatically registered after 3 December 2012. These organisations have until 2 June 2013 to opt out of registration. It should be noted, however, that not registering with the ACNC may affect an entity's entitlement to obtain and/or retain applicable tax concessions.[7]

5 'New charities regulation unnecessary', *The Australian Financial Review*, 8 February 2013

6 Australian Government, *Budget Measures to Strengthen the Not-for-profit Sector* http://www.notforprofit.gov.au/sites/default/files/files/Not-for-Profit%20Sector%20Guide%20to%20the%20Budget%202011-12.pdf

## Statutory definition of charity

As mentioned, the determination of an entity's charitable status will now be the responsibility of the ACNC, whose determinations will be based on a codified definition of 'charity' as of 1 July 2013[8] and will apply for all commonwealth purposes. Charities will then be required to self assess their eligibility for charity status on an ongoing basis, subject to periodic review by the ACNC.

The determination of eligibility to access commonwealth tax concessions that are subject to special conditions will remain the Australian Taxation Office's responsibility.

The current definition of 'charity' is based on 400 years of common law, beginning with the preamble to the Statute of Charitable Uses enacted by the English parliament in 1601 (the Statute of Elizabeth) and the case of *Commissioners for Special Purposes of Income Tax v Pemsel*.[9] Informed by the Statute of Elizabeth, the Pemsel case established four heads of charitable purposes that courts still refer to today:

7 Australian Charities and Not-for-profits Commission, *Timeline of what charities need to do*

8 *Australian Future Tax System* report in 2010; Productivity Commission in its 2010 *Report Contribution of the Not-for-profit Sector*; and 2010 Senate Economics Legislation Committee report into the Tax Laws Amendment (Public Benefit Test) Bill 2010

9 [1891-1894] All ER Rep 28

1. the relief of poverty;
2. the advancement of education;
3. the advancement of religion; and
4. other purposes beneficial to the community.

Recognising that the definition may need a more contemporary application, the proposed definition will be informed by the 2001 Report of Inquiry into the Definition of Charities and Related Organisations[10] and the High Court case of *Aid/Watch Incorporated v Commissioner of Taxation*.[11]

A formal definition is yet to be announced and will be subject to the states' and territories' acceptance if it is to apply in those jurisdictions.

10 Australian Taxation Office Non-profit News Service *No 0325 – 2011-12 Budget: Measures relevant to non-profit organisations*, 6 June 2011
11 [2010] HCA 42


## Tightening of tax concessions

Tax concessions are available to around 10 per cent of Australia's NFP sector, and amount to an estimated $4 billion of quantifiable government support.[12] As part of the Australian government's reform to better target these concessions, numerous changes are proposed to occur regarding income tax, goods and services tax (**GST**) and fringe benefits tax (**FBT**) exemptions, as well as tax deductibility of gifts.

### Income tax

In 2011-12, income tax exemptions accounted for 75 per cent of the total tax concessions provided to the NFP sector.[13] For NFPs listed in the legislation, all ordinary and statutory income is exempt from income tax[14] and refunds of franking credits are available to them where certain criteria are met. For other NFPs, only the first $416 of their income is exempt.

However, if the proposed reforms to the NFP sector are actualised, all tax-exempt NFPs will soon be expected to pay income tax on profits generated from unrelated commercial activities that are not directed back to their altruistic purposes.

The revised forecast for the application date of this constraint is 1 July 2014 for any new activities commencing after 7.30pm on 10 May 2011, and 1 July 2015 for any activities commenced before 7.30pm on 10 May 2011.[15]

12 Australian Government Productivity Commission Research Report, Contribution of the Not-for-profit Sector, January 2010 http://www.notforprofit.gov.au/about-us/about-us-page-1
13 Treasury, *Tax Expenditure Statement*, 2011, Items B63, B68, B69, B70
14 Subdivision 50A of the *Income Tax Assessment Act 1997*

While small-scale and low risk activities (eg bake sales, op-shops) are not intended to be affected by this reform;[16] it will be interesting to see whether the relevant legislation adopts the view expressed by the High Court in Commissioner of Taxation of the *Commonwealth of Australia v Word Investments Ltd*.[17] In that case, the court determined that profits from the unrelated commercial activities of one NFP directed to another NFP that advance the former's altruistic purposes are also exempt from income tax.

### Fringe benefits tax & goods and services tax

Since the introduction of the fringe benefits tax system in 1986, numerous NFP entities, depending on their nature, have been exempt – up to specified caps or through a rebate-system – from paying tax on fringe benefits provided to employees.[18] In 2011-12, this concession cost the Australian government an estimated $1.3 billion.[19]

Similarly, in addition to some fundraising events by NFPs being input taxable, a number of charitable activities and non-commercial supplies of goods and services by NFPs have been exempt from GST since its introduction in 2000. A further GST tax concession aiming to encourage support of the NFP sector is that

15 Assistant Treasurer Press Release 31 January 2013
16 Australian Taxation Office Non-profit News Service *No 0325 – 2011-12 Budget: Measures relevant to non-profit organisations*, 6 June 2011
17 Commissioner of Taxation of the *Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55
18 Sections 57A and 65J of the *Fringe Benefits Tax Assessment Act 1986*
19 Treasury, *Tax Expenditure Statement*, 2011, Item D14

voluntary, non-material donations to NFPs are GST-free.

As of 1 July 2014 or 1 July 2015, depending on whether the relevant activities were commenced before or after 10 May 2011, these two concessions will no longer be available where the earnings from unrelated commercial efforts are not channelled back to advance the NFP's altruistic purpose.[20]

## Deductible gift recipients

Another tax concession available to certain entities in the NFP sector is the provision of 'Deductible Gift Recipient' (**DRG**) status to those endorsed by the ATO or named in the legislation. This status allows for donations to eligible NFPs to be tax-deductible, offering an incentive to the community to offer its financial support.

$910 million of government revenue was forgone in 2011-12 as a result of this allowance.[21]

The proposed reform intends to remove DRG status from unrelated businesses run by charitable organisations unless the profits generated are put back into their charity work.[22]

Without these measures codified in any final form, speculation as to the efficacy of these reforms is – quite literally – mere speculation. However, there is mounting literature critiquing the proposed tightening of tax concessions for NFPs on the basis that the proposal 'lacks an evidence base, is unduly complex in its design, and lacks coherent rationale'.[23]

For example, despite the argument that income tax concessions allow NFPs to gain a competitive advantage by charging lower prices, in recent reports by the Industry Commission, the Productivity Commission and the Henry Tax Review, it was found that both in theory and practice, income tax exemptions do not inform the decisions of organisations in relation to price-setting.[24]

Similarly, while insisting that tax concessions apply only to income that is applied to the NFP's altruistic purposes, the test is one-dimensional in the sense that it only examines the application of income and not the relatedness of income, which may be a more appropriate threshold.[25]

This paper will now address a key implication resulting from the design of the new reforms.

## Duplication of governance and disclosure requirements

Existing state and territory legislation, albeit different between jurisdictions, regulates the governance and reporting obligations of certain forms of charitable entities. While the Council of Australian Governments (**COAG**) is working to achieve a degree of uniformity between the jurisdictions, the situation has been complicated by the introduction of the new ACNC legislation, which also imposes governance and reporting requirements on these entities. There is concern that this duality has created additional and arguably superfluous compliance burdens for charities, and is in direct conflict with the government's objective of minimising regulatory compliance costs to the NFP sector.

According to COAG's Regulatory Impact Assessment of Potential Duplication of Governance and Reporting Standards for Charities,[26] there are two major areas of duplication that need to be addressed:

- the requirement that 'responsible entities' (as defined in section 205-30 of the ACNC Act), take reasonable steps to

20 Assistant Treasurer Press Release 31 January 2013

21 Treasury, *Tax Expenditure Statement*, 2011

22 Australian Taxation Office Non-profit News Service No *0325 – 2011-12 Budget: Measures relevant to non-profit organisations*, 6 June 2011

23 Miranda Stewart and Joyce Chia, 'Doing Business to do Good: Should we tax the business profits of charities and not for profits?'

24 Industry Commission, *Charitable Organisations in Australia* (16 June 1995); Productivity Commission, *Contribution of the Not-for-profit Sector* (Research Report, 11 February 2010); Treasury and Australia's Future Tax System Review Panel, *Henry Review* (2010)

25 Miranda Stewart and Joyce Chia, 'Doing Business to do Good: Should we tax the business profits of charities and not for profits?' p17

26 Available online at http://www.coag.gov.au/sites/default/files/COAG%20Regulatory%20Impact%20Assessment%20of%20Potential%20Duplication%20of%20Governance%20and%20Reporting%20Standards%20for%20Charities.pdf

comply with duties[27] that are to a large extent the same as those owed by directors under the *Corporations Act 2001* (Cth) (**Corporations Act**); and

- the auditing, annual financial reporting and notification of changes to particulars requirements of the ACNC Act,[28] which overlap with current disclosure obligations under the relevant state and territory legislation.

It should be noted, however, that the extent of duplication for incorporated associations is likely to be more significant than that of unincorporated associations and other bodies that are not subject to state and territory legislation.

27 Part 3.1 of the ACNC Act
28 Parts 3.2 and 3.3 of the ACNC Act


A report by the Standing Council on Federal Financial Relations is expected to be provided to COAG in early March 2013 to inform discussions between the various jurisdictions on how to reduce regulatory duplication.

While the legislation intended to give effect to the proposals of the May 2011 Budget regarding the NFP sector has been deferred to 1 July 2014 for any new activities commencing after 7.30pm on 10 May 2011, and 1 July 2015 for any activities commenced before 7.30pm on 10 May, the national regulator, the ACNC, has commenced operations. It appears that a statutory definition of 'charity' will still be announced and take effect as of 1 July 2013.

Without a clear legislative framework and uncertainty as to the coexistence of the ACNC and other regulators of entities within the NFP sector, charities and other NFPs may find it difficult to prepare for the proposed reform and should keep up to date with any developments. In anticipation of the various changes, NFPs are encouraged to:

- enquire as to whether they have been or need to be registered with the ACNC;
- taking into account the tax implications of non-registration, opt out of registration with the ACNC if appropriate;
- review, consolidate and update the entity's constitution, financial and operational records, and policies and procedures to ensure they are accurate, current and complete; and
- consult with an accountant or tax specialist to determine which of the company's unrelated commercial activities (if any) are likely to be affected by the proposed tightening of tax concessions and the impact this is likely to have on the entity.

## Appendix 1 – Measures to assist NFPs as proposed by the May 2011 Budget

- Collaboration between the National Compact, Job Services Australia and the NFP sector to provide increased support for job seekers, early school leavers, mature age workers and people needing assistance
- Availability of grants for providers of regional legal assistance to the NFP community
- Establishment of a Local Solutions Fund to support programs in ten disadvantaged Australian communities
- Supplementation of current program funding for children, students and adults with disabilities and children with autism
- Extension of funding emergency relief and financial counselling services
- Additional wage subsidisation to employers who employ people with disabilities
- Additional funding for the Communities for Children service
- Expansion of Family Mental Health support and supplementary funding for youth mental health centres
- Expansion of integrated services and coordinated care for people in the social services and mental health services
- A one-off grant to the Australian Red Cross to support

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humanitarian relief initiatives

- Allocation of funding to aged care providers in rural and remote areas
- Provision of funding to Indigenous organisations and health services
- Funding to education service providers for active after-school community programs
- Availability of grants to community and heritage preservation groups
- Amendments to the Building Australia's Future Package (**BAFP**)
- Reduction to funding of the Department of Veteran's Affairs grant programs.

Authored by: **Michael Kohn and Ora-Tali Korbl**, Cornwall Stodart

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**For further information please contact:**

**Michael Kohn,** Partner
Phone (direct) **+61 3 9608 2160**
Mobile **+61 408 327 805**
Email **m.kohn@cornwalls.com.au**