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## **Senate Economics Reference Committee**

### **Finance for the not-for-profit sector**

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### **Introduction**

Thank you for the invitation to meet with the Committee. I represent the Australian Charity Law Association in my capacity as a Director. I bring apologies from ACLA's President, Anne Robinson. Her duties as Deputy Chair of the Not-for-Profit Sector Reform Council keep her in Sydney today. It is a busy time in the not-for-profit sector.

I am a Director of the Australian Charity Law Association which is a professional organisation addressing current legal issues affecting charitable entities in Australia and thereby assisting the charitable sector as a whole. It has patronage of Sir Anthony Mason, former Chief Justice of the High Court of Australia and its Board comprises leading practitioners and academics in the not-for-profit sector.

My personal experience of the sector comes from 30 years as a private practitioner with Moores Legal advising the sector, Chair of Ansvar Insurance which is a specialist insurer to the sector, Chairman of National Housing Company which is presently endeavouring to raise capital to provide 5,000 affordable homes in Australia utilising the NRAS Incentives.

We have not put in a written submission. My opening remarks will be addressed to issues around the reform agenda generally and implications for finance for the not-for-profit sector. I may take more than my 5 minutes but not more than 10.

### **Reform Agenda**

The sector has welcomed the current climate of reform and the recognition particularly in the National Compact of a new understanding of partnership between government and non-government organisations in the sector.

The conversation recognises the value to a civil society of a well resourced not-for-profit sector. It extends to the problem of finance for the sector.

When the Henry Report was published the Prime Minister and Treasurer quickly moved to assure the sector that the reforms would do no harm to the Sector.

The reality is different. The sector perceives that ambitious or entrepreneurial ventures are often regarded as a threat to the revenue and inhibited by slow, inconsistent and unsympathetic treatment in policy and practice. There are a number of practical barriers to NFPs generating income to build a balance sheet.

### **Word**

Word Investments case is a case in point. In that case the means of fundraising for a charitable purpose was the conduct of a funeral business. Justice Alsop in the Federal Court drew the analogy of a lamington drive at a local school. The method of fundraising for a charitable purpose ought not be a disqualifying factor. Yet the outcome of the case was neglected in ATO rulings for the ensuing two years until the announcement on budget night 2011 that the Word decision would be reversed through an unrelated commercial activities tax and a restatement of the "in Australia" test to confine charity mainly to the benefit of onshore Australians. This legislation by announcement without sector consultation has lead to uncertainty, expense and sometimes paralysis in the sector. It is not calculated to encourage innovation or investment.

### **UBIT**

The proposed Unrelated Commercial Activities Tax or Unrelated Business Income Tax ("UBIT") announced in the 2011 Budget, intends to tax surpluses retained by NFP's for working capital purposes. It is antithetical to building access to capital. There is no demonstrated mischief that it prevents. The forward estimates in the budget indicate that this will raise no revenue and indeed that is the experience overseas. It will simply put another layer of compliance and structuring requirements over the sector.



Implicit in the UBIT is the curious distinction between passive investment and active investment. Should an organisation become too entrepreneurial and take active business risk, it will be penalised for that activity. The sector is encouraged to be passive in its fundraising. It is also encouraged to be small so as not to exceed the scope of activity thresholds. We anticipate there will be constant demarcation questions as to what is related and what is unrelated.

## **NRAS**

The response of the Australian Taxation Office to charitable and public benevolent institutions becoming involved in the National Rental Affordability Scheme was to threaten to withdraw charitable concessions from Housing Associations because beneficiaries of housing under the scheme may not be poor enough to deserve charity. Parliament applied a temporary legislative fix for the opening rounds of NRAS funding but those organisations not eligible in subsequent rounds are now in contest with the Australian Taxation Office over eligibility for tax concessions because of involvement in the NRAS scheme.

Our plea is for the enabling of the sector rather than treating the sector with suspicion as a drain on civil society.

## **Ancillary Funds**

Ancillary Funds exist for the purpose of funding other NFPs. Increased regulation and increasing limitations on accumulation are hampering their growth and effectiveness. Trustees are electing to wind up ancillary funds rather than be burdened with the additional requirements of compliance, limitations on accumulations, and the requirement that the Trustee be a constitutional corporation despite real doubts as to whether charitable corporations are such and the existence of many funds where Church Wardens and other bodies corporate are trustees..

## **Structuring**

I would like to say something about the structuring. The structures available to the not-for-profit sector - particularly a

company limited by guarantee under Federal arrangements are generally well suited to carry out a not-for-profit purpose. The problem lies not so much in the structuring of the organisation but the availability of viable fundraising instruments.

The very nature of the NFP entity is that it cannot by definition access equity finance. It is prohibited from providing return for equity contribution. Equity risk and reward is inimical to the concept of an NFP. The NFP needs to make do with debt funding, or accumulated reserves from its NFP business activities. Its ability to do the former is restricted by the absence of lower priority equity contributions and generally thin balance sheets: its ability to do the latter is restricted by the looming UBIT. Its directors generally do not give guarantees. Its future income streams are uncertain and often limited by short term government funding arrangements. The submissions of the Benevolent Society and Lifehouse at RPA concerning early experience of social bonds in Australia point out that converting initial interest into funding commitments is challenging. The GoodStart model had a number of unique features that meant that the market commensurate bonds were effectively mezzanine debt.

Government intervention by guarantee of principal and/or returns, franking credits, and incentives to involve Ancillary funds to invest in Social Bonds could help prime the pump.

Government guarantees to re-assure the markets are not unprecedented.

## Conclusion

In short we plead for a mindset of enabling the sector, an openness to creative approaches to delivering social outcomes and a realisation of the aspirations of the National Compact in the treatment of not-for-profit entities. Finally there is room for a greater alignment between government policy, treasury proposals and ATO practice. Tax law is a blunt instrument for implementing the Government's policy intent: leave it to the ACNC to develop and manage an appropriate and constructive compliance regime.

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