NOT-FOR-PROFIT PROJECT, UNIVERSITY OF MELBOURNE LAW SCHOOL

SUBMISSION TO THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

EXPOSURE DRAFT, AUSTRALIAN CHARITIES AND NOT-FOR-PROFITS COMMISSION BILL 2012

25 July 2012

ABOUT THE NOT-FOR-PROFIT PROJECT

The University of Melbourne Law School's Not-for-Profit Project is a three-year research project funded by the Australian Research Council. The NFP Project began in 2010 and is the first comprehensive Australian analysis of the legal definition, regulation and taxation of not-for-profit (NFP) organisations. Appendix A provides further information about the Project and its members.

The NFP Project welcomes this opportunity to provide a submission to the House of Representatives Standing Committee on Economic to assist its inquiry into the provisions of the Australian Charities and Not-for-Profits Commission Bill and the Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill (hereafter referred to as the ACNC Bill). The NFP Project has been engaged in the consultation process for the ACNC Bill and other NFP reforms and has made a number of submissions to the Treasury, including:

- A submission to Treasury's Consultation paper on *A Scoping Study for a National Not-for-Profit Regulator* (January 2011);
- A Working Paper on Regulating the Not-for-profit Sector (July 2011);
- A submission to the ACNC Implementation Taskforce on Implementation Design (February 2011);
- A submission to Treasury's Consultation Paper on Review of the Governance Arrangements

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for Not-for-profits (January 2012); and

- A submission to the Treasury on an earlier exposure draft of this Bill (July 2012);

These documents, as well as other documents relating to NFP Reform can be downloaded from the Project's website at http://tax.law.unimelb.edu.au/notforprofit1#Publications.

OUTLINE OF THIS SUBMISSION

In our submission, we draw upon our previous submissions to the Treasury and the ACNC Implementation Taskforce as well as research conducted by the NFP Project into comparable national regulators and the regulation of charities and NFPs overseas.

We welcome the establishment of the ACNC, which will provide much needed national regulation and a 'one-stop-shop' for the regulation of charities and eventually the NFP sector. We particularly welcome the staged approach taken to regulation in this area, beginning with charities with the potential to expand regulation to the NFP sector more generally. We welcome the introduction of the revised Bill as a matter of principle. We also note that the draft Bill contains a clear statement of support for the NFP sector as set out in the Preamble (newly introduced) and in the amended Objects clause. We note that this changes the focus of the Bill to make it clear that the ACNC will be primarily concerned in facilitating as opposed to regulating the NFP sector.

We note that concerns that we raised during previous consultations, have, for the most part, been addressed in this version of the Bill. However, we would like to raise a number of matters for further consideration. Those matters fall into two categories: first, there are a number of matters concerning the scope of the ACNC Bill and secondly, there are some matters of a procedural nature. Given the short time frame for the Standing Committee's inquiry, we wish to draw the Committee's attention to the following issues:

1. Issues about the scope or application of the legislation

There are a number of issues relating to the scope or application of the legislation. They include:

- Identification of the Constitutional basis for the ACNC legislation;
- The exemption from various requirements for 'basic religious entities';
- The definition of 'not-for-profit' entity and the position of entities that voluntarily de-register; and
- The position of charity-like government entities.

Constitutional basis

The Constitutional basis for the ACNC legislation has been taken out of the Bill but is discussed in the Explanatory Memorandum (EM). This may not make too much difference as a matter of law but it is probably preferable to include the relevant heads in the legislation to provide a guide for all NFPs. We note that the heads of power referred to are very broad and involve a significant range of powers. This issue is likely to be important because of the doubt concerning the Commonwealth's constitutional power over trustees eg the power to remove trustees.

The exemption for 'basic religious entities'

The exemption from disclosure (s 60-60) and from the governance standards (s 45-10) for 'basic religious entities' (defined in s 205-35) is very unusual. There is no explanation for the special treatment in the Explanatory Materials and no other charitable entity type attracts this treatment. The exemption does not apply if the entity is a deductible gift recipient (DGR) or operates a DGR fund. However, the large churches tend to undertake these activities in separate entities. As a result, the church itself would not be subject to reporting requirements that apply to all other charities.

The Commissioner has a discretion under s 40-10 of the Bill to withhold information from the register if persuaded that the disclosure is inappropriate, according to criteria set out in the legislation. It is difficult to justify a blanket exemption for religious entities while requiring other entity types such as Private Ancillary Funds (PAFs) to justify the withholding of information on a case-by-case basis. Given the existence of the discretion it would be more appropriate to allow all entities (including religious entities) to apply if they believe that the disclosure of information:

- is commercially sensitive; and has the potential to cause detriment to the registered entity (or former registered entity) to which it relates, or to an individual;
- is inaccurate, likely to cause confusion or mislead the public;
- is likely to offend a reasonable individual;
- could endanger public safety; or
- in circumstances specified in the regulations.

We generally support the inclusion of such a discretion but do not favour the blanket exemption for religious bodies.

Definition of Not-for-profit; voluntary de-registration

The definition of 'not-for-profit' in s 900-5 of the Bill refers to the definition in the *Income Tax Assessment Act 1997.* There is a note that states that "the definition will be included in the *Income Tax Assessment Act 1997* in legislation intended to be introduced by the Government". That legislation is still in the form of a (revised) *Exposure Draft - Taxation Laws Amendment (2012*

Measures No 4) Bill 2012: Tax exempt body "in Australia" requirements. This legislation is contentious and may not be passed before the date set for commencement of the ACNC (1 October 2012). Given the significance of the term for the ACNC Bill we recommend including the same definition in the consequential and transitional amendments Bill so that it comes into force at the same time as the ACNC Bill. The definition could then be part of the *Income Tax Assessment Act 1997* or could be cross-referred to.

We also note that the ACNC will only have authority in relation to registered entities so that if an entity voluntarily de-registers, the ACNC cannot take any action. This should be quite easy to fix eg by reference to a formerly registered entity in relation to activities carried out or entered into while the entity was registered and therefore entitled to tax concessions.

Government entities

More clarity is required about government entities. The Explanatory Materials at para 3.28 state that charity-like government entities will not be able to register under the ACNC Bill. This seems to ignore the decision in *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* (High Court, 2006) and also the fact that many museums and galleries are currently endorsed as charities. It also fails to recognize that there are a variety of bodies that receive government funding and may have representatives of government departments on their governing boards but which operate independently of government and rely heavily on private funding. It is suggested that all references to charity-like government entities be removed from the Explanatory Materials and that the matter be given further consideration in relation to the definition of charities.

2. Issues related to procedure

There are a number of issues related to the procedure to be followed by the ACNC. They include:

- the absence of provisions to ensure procedural fairness in the Commissioner's decision-making and exercise of regulatory powers;
- the creation of governance and external conduct standards in regulations and the threshold for the exercise of regulatory powers on the grounds of likely non-compliance with the standards;
- the potential that the secrecy provisions will operate to inhibit the ACNC's ability to share information appropriately with other regulators; and
- the necessity for, and effectiveness of, the administrative penalty regime.

Procedural fairness

Procedural fairness means providing reasons for decisions, giving individuals affected by regulatory decisions an opportunity to be heard, and giving people fair time periods to comply with decisions. Procedural fairness provisions will benefit both the NFP sector and the ACNC itself. Compliance with procedural fairness ensures that people are aware of the reasons why they are treated in a particular way, and also contributes to the accuracy of the regulator's decisions and increases public confidence in those decisions.[1]

Of particular concern is the absence of appropriate procedural fairness requirements in relation to the ACNC's exercise of its powers to revoke an entity's registration (Div 35) and the suspension and removal of responsible entities (Div 100). Both outcomes are quite severe sanctions and would ordinarily attract the obligations of procedural fairness.

We raised similar concerns about procedural fairness in previous submissions and consultations with the Treasury.[2] We understand that these concerns were not addressed in the current draft because it was felt that procedural fairness provisions were unnecessary given that Part 7-2 of the Bill sets out procedures to review decisions made by the Commissioner.

We agree that the general objection/appeal process in Part 7-2 is suitable for review of particular cases. Nonetheless, we submit that a response of this kind confuses procedural fairness with administrative review. Imposing clear legislative obligations on the ACNC in relation to the procedures by which it makes significant regulatory decisions ensures that decisions are made properly at first instance and increases public confidence in the regulator. Without such provisions, the ACNC is left in great uncertainty as to whether it has fulfilled its obligations and increases the likelihood that its decisions will be challenged on the grounds that it has failed to provide procedural fairness in accordance with its common law obligations. It also leaves the Bill out of step with every other major piece of Commonwealth regulatory legislation, all of which clearly define the procedural steps for hearings and notices prior to regulatory decisions being made.[3]

Including provisions in the Bill for a general opportunity to be heard prior to a decision being made is fairer, more flexible, and more likely to produce accurate decisions than the option for the review

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[1] Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report, No 95, 13 March 2003) <http://www.alrc.gov.au/report-95>, [14.5]–[14.7], [15.5].

[2] Not-for-Profit Project, University of Melbourne Law School, *Submission to the Treasury: Exposure Draft, Australian Charities and Not-for-Profits Commission Bill 2012,* 21 January 2012, http://tax.law.unimelb.edu.au/notforprofit1, pp 34-44.

[3] Our earlier submission to the Treasury provided details of such precedents in Australian legislation, including the *Australian Securities and Investments Commission Act 2001* (Cth), *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth), *Corporations Act 2001* (Cth), *National Vocational Education and Training Regulator Act 2011* (Cth), *Tertiary Education Quality and Standards Agency Act 2011* (Cth) as well as overseas legislation relating to the regulation of charities: pp 36-41.

of decisions. It is fairer because it permits an entity to respond to a claim before an administrative decision is made, which may have significant practical and reputational consequences. It is more flexible because, once a decision is made the relatively formal process of objection is required. Administratively, there may be benefits in allowing organisations to clarify concerns held by the regulator without triggering the review process. Finally, it promotes accurate decision making because decisions will be made after appropriate information is laid before the regulator.

Governance and External Conduct Standards

Part 3 of the Bill provides that regulations may be made to set out minimum standards for the governance of registered entities and their external conduct, that is, the conduct of registered entities in relation to activities outside of Australia.

We note that current uncertainty about the scope and content of these standards is of particular concern to the NFP sector. We are strongly of the view that regulations should only be made after extensive consultation with the NFP sector. The NFP sector involves a diverse range of organisations, with different kind of governance arrangements and activities. The benefit of leaving these standards to regulations is that it will enable rules to be tailored to meet the diversity of the NFP sector.

The threshold of a reasonable belief that an entity is likely not to comply with a governance or external conduct standard is a very low threshold for the imposition of sanctions of this kind. We therefore recommend that the Commissioner should be required to believe, on reasonable grounds, that an entity is *reasonably likely* to not comply with a governance or external conduct standard before he or she can exercise these enforcement powers.

Secrecy Offences and Ability to Share Information with Other Regulators

The ACNC needs to be able to co-operate with other regulators in order effectively to fulfill its functions as both a regulator and as a 'one stop shop' for charities.

One key aspect of this co-operation is the ability to share information. In our previous submission to the Treasury and subsequent consultations we expressed concerns that the secrecy offences set out in the Bill were unnecessarily onerous and inhibited the ACNC's ability to appropriately share information with other regulators, for example where the protected ACNC information discloses that there has been a breach of other laws, such as fundraising, taxation, trust or criminal laws.[4] Some of these concerns have been addressed in the current draft. However, there are still issues about the restrictive operation of the secrecy offences. For example:

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[4] Not-for-Profit Project, University of Melbourne Law School, *Submission to the Treasury: Exposure Draft, Australian Charities and Not-for-Profits Commission Bill 2012,* 21 January 2012, http://tax.law.unimelb.edu.au/notforprofit1, pp 59-62.

- Section 150-30: permits the use of information by an ACNC officer in the performance of duties 'under this Act'. Those words are restrictive ie they make it doubtful whether an ACNC officer could use the information in performing functions under other Acts, duties in policies or guidelines or under international treaties, and should be deleted;

- Section 150-40(d) requires that a disclosure be 'reasonably necessary to promote the objects of this Act.' These words are also capable of being interpreted as a restriction and should be deleted.

- Sections 150-50(b) and 150-65(b) require the disclosure of information to be 'for the purposes of this Act'. The restriction again seems to be inappropriate and should be deleted.

Administrative Penalty Regime

Division 175 sets out a rather complex regime for the imposition of administrative penalties where an entity makes false or misleading statements to the Commission or fails to lodge documents in time. The administrative penalty regime is justified in the Explanatory Memorandum by the impact on the ACNC and the public at large if entities were to provide incorrect or untimely information.

Administrative penalties are imposed by the regulator, rather than a court, generally as an alternative to more serious civil or criminal penalties. They are commonly used in the taxation context and under the *Corporations Act*. The ACNC is not, however, operating at the same scale as the taxation and corporate law systems where administrative penalties provide an efficient and effective means of ensuring compliance.

At a general level, we question whether administrative penalties are an appropriate regulatory tool in this context. Administrative penalty regimes are administratively complex, in that their implementation and administration require sophisticated systems and a high level of cooperation between the regulator and the Australian Taxation Office. This seems to impose a large burden on the ACNC when the same regulatory goal (the provision of timely and accurate information) will be achieved first and foremost through the sector's trust and confidence in the regulator's role, and through the other enforcement options that are available to the regulator when registered entities fail to meet their obligations.

The Explanatory Materials state that it is not expected that administrative penalties will be frequently imposed (paragraph 13.93). However, as we discuss further below, the automatic nature of the operation of the administrative penalty system means that the ACNC has little discretion about when to impose an administrative penalty, rather than use softer regulatory tools. We therefore submit that the administrative penalty regime is a disproportionate regulatory tool in this context and should be removed from the Bill.

A better option would be to either make late lodgment of documents a criminal offence, requiring proof of intent, or include no specific penalties at all. For example, the *Corporations (Aboriginal and*

Torres Strait Islander) Act 2006 (Cth) makes it an offence for a corporation, and in some cases, officers of the corporation to fail to lodge particular documents with the regulator. Most offences of this kind carry a penalty of 5 penalty units.[5]

Alternatively, it may be appropriate that the Bill include no additional penalty for the late lodgment of documents. While we consider that either approach would be preferable to the current administrative penalty regime proposed in the Bill, on balance we submit that there is no need for the Bill to include either administrative or criminal penalties for the late lodgment of documents. Failure to lodge documents in time would be a contravention of the Act and will therefore be grounds for the Commissioner to exercise the enforcement powers, including formal warnings, directions, enforceable undertakings, injunctions and the suspension and removal of a responsible entity. These enforcement powers are sufficient for the Commissioner to deal appropriately and proportionately with entities that fail to lodge documents in time.

CONCLUSION

We thank the Standing Committee again for the opportunity to comment on this Exposure Draft to implement an important policy initiative. Should the Committee have any questions or require further information, please do not hesitate to contact us.

[5] *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) ss 69-20, 88-1, 112-5, 115-5, 265-40, 304-5, 304-15. These offences were intended to align with similar offences in the *Corporations Act 2001* (Cth).

APPENDIX A: THE NOT-FOR-PROFIT PROJECT

The University of Melbourne Law School is undertaking the first comprehensive and comparative investigation of the definition, regulation, and taxation of the not-for-profit sector in Australia (the Not-for-Profit Project). The Australian Research Council is funding this project for three years, beginning in 2010. The Project aims to identify and analyse opportunities to strengthen the sector and make proposals that seek to maximise the sector's capacity to contribute to the important work of social inclusion and to the economic life of the nation. In particular, the project aims to generate new proposals for the definition, regulation and taxation of the not-for-profit sector that reflect a proper understanding of the distinctions between the sector, government and business.

The investigators on the Not-for-Profit Project are:

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More information on the project can be found on the website at http://tax.law.unimelb.edu.au/notforprofit. For further details or to contact the Project members, email law-nfp@unimelb.edu.au.