



pilch

promoting law in the public interest

Removing complexity, adding coherence:

**A proper framework for concessional tax treatment of charities
and not-for-profit entities**

17 October 2008

Removing complexity, adding coherence:

**A proper framework for concessional tax treatment of charities
and not-for-profit entities**

Submission by:

**PilchConnect, a specialist legal service for community
organisations**

To:

Australia's Future Tax System Review Panel

Sue Woodward, Manager, PilchConnect

Ben Fisher, Seconded Lawyer

Public Interest Law Clearing House (PILCH) Inc
Level One, 550 Lonsdale Street
Melbourne VIC 3000

T: (03) 9225 6680

F: (03) 9225 6686

E: sue.woodward@pilch.org.au

seconded2@pilch.org.au

CONTENTS

1. Scope of submission	2
2. About PILCH	2
3. About PilchConnect	3
4. Size of Australian NFP sector	3
5. Significance of Australian NFP sector	4
6. Development of charity law	4
7. Taxation legislation and the ATO – default regulators of charity law in Australia	5
8. Problems with existing regulatory environment	6
9. Conclusions and recommendations	8

1. Scope of submission

1.1 The Public Interest Law Clearing House (**PILCH**) and PilchConnect welcome the opportunity to contribute to the Australia's Future Tax System Review Panel by the Senate Economics Committee. We commend the Senate Economics Committee on its initiative to undertake a comprehensive inquiry into Australia's taxation system.

1.2 We wish to make submissions with regard to tax concessions provided to charitable and related entities under taxation legislation as regulated by the Australian Taxation Office.

This submission should be read in light of overarching recommendations for a better regulatory framework for the not-for-profit sector made in our more comprehensive submission to the current Senate Inquiry into Disclosure Regimes for Charities and Not-For-Profit Organisations.¹

2. About PILCH

2.1 PILCH is a leading independent, Victorian, not-for-profit organisation that is committed to furthering the public interest by improving access to justice and protecting human rights. It does this by facilitating the provision of pro bono legal services and undertaking law reform, policy work and legal education. PILCH's current annual budget is \$1.7M and we have a staff of 20 eft.

2.2 PILCH was founded in 1994 and is now Australia's largest provider of pro bono legal services. This assistance is provided to marginalised and disadvantaged individuals and to not-for-profit organisations. PILCH provides its clients with a unique 'one-stop shop' by co-ordinating six assistance schemes and services:

- the Public Interest Law Scheme (funded by the members of PILCH)
- the Victorian Bar Legal Assistance Scheme
- the Law Institute of Victoria Legal Assistance Scheme
- PilchConnect (for not-for-profit (**NFP**) organisations – see heading 3)
- Seniors Rights Victoria (in partnership with other NFP organisations), and
- the Homeless Persons' Legal Clinic (an outreach service offered at 11 locations).

2.3 PILCH is also a co-founder (and is co-located with) the Human Rights Law Resource Centre.

2.4 While PILCH's activities are focused in Victoria, much of our law reform work has national application and some of the services developed by PILCH have been replicated by our counterparts in other States (eg, the Homeless Persons' Legal Clinic model).

¹ See PILCH website www.pilch.org.au and http://www.aph.gov.au/Senate/committee/economics_ctte/charities_08/submissions/sub129.pdf

3. About PilchConnect

3.1 PilchConnect is a new specialist legal service for NFP community organisations established by PILCH in November 2007. It is being piloted in Victoria with a view to a national rollout. PilchConnect's mission is to promote and support the highest possible standards of governance by NFP organisations so that their economic and social contribution to Australian society is maximised.

3.2 PILCH is itself an NFP and the PilchConnect service represents a sector-based response to increasing demand by NFPs for legal assistance. The service provides free or low cost assistance to NFP community organisations on a wide range of legal and legally-related issues. PilchConnect's services include:

- a monthly seminar program for NFPs on legal issues relevant to NFPs, such as incorporation, governance, volunteers, tax status and concessions, fundraising and regulatory compliance;
- a web portal that maps and links existing, up-to-date and reliable legal information, as well as providing a range of new plain language resources under the framework of the 'life cycle' of a NFP organisation (to be launched on 19 November, 2008);
- a telephone advice service (forthcoming 2009); and
- a legal referral service, whereby eligible 'public interest' NFPs that have complex legal issues are matched with PILCH member law firms who are willing to provide pro bono legal assistance.

3.3 Our NFP service delivery experience informs PilchConnect's law reform work on issues of importance to the NFP sector (eg, submission to the Federal Treasury Discussion Paper on 'Financial Reporting of Unlisted Public Companies' 2007, and recently, to Senate Inquiry into Disclosure Regimes for Charities and Not-For-Profit Organisations, 2008).

4. Size of Australian NFP sector

4.1 Official statistics show that the NFP sector plays a significant role in Australia's economic well-being (see ABS 2001, ABS 2008² and 'Giving Australia Report' 2005³).

² <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8106.0Main+Features32006-07> It is important to note that the ABS figures relate only to NFPs that have registered with the ABR for an ABN.

³ *Giving Australia Report*, a major research report commissioned by the (then) Department of Family and Community Services, on behalf of the Prime Minister's Community Business Partnership released 10 October 2005: http://www.partnerships.gov.au/philanthropy/philanthropy_research.shtml

4.2 According to the Australian Bureau of Statistics, Australia's 40,976 registered NFP organisations generated \$74.5 billion income in 2006-07. They employed 880,000 and were assisted by more than 2.4 million volunteers.⁴

4.3 The NFP sector contributes (if an imputation is made for the value of services provided by volunteers) 4.9% of Australia's GDP. On this basis, the Australian Bureau of Statistics figures show that the NFP sector contributes more to GDP than the government administration and defence (4.1%) and mining (4.6%).⁵

5. Significance of Australian NFP sector

5.1 The figures above do not take into account the qualitative contribution of the NFP sector – for example, the role it plays in social inclusion and the delivery of government services. The NFP sector touches every Australian in some way, as a recipient and/or as a donor (of time or money).

5.2 The importance of the NFP sector in both the Australian economy and Australian society is such that PilchConnect submits that the Australia's Future Tax System Review Panel should consider the state of the current tax system with regard to NFP entities.

6. The development of charity law

6.1 Charitable law exists to support the right of people to give money for public benefit and to protect the value of that gift.

6.2 From a legal perspective, charity was first addressed in the Preamble to the Statute of Elizabeth in 1601. Since then the meaning of charity has been examined through 400 years of common law cases in countries - including Australia, the USA, Canada and New Zealand – which have inherited laws and legal principles from Great Britain. As such, the law relating to charities is not a unified coherent body of jurisprudence. In fact, the concept of charity has largely eluded formal legislative definition and there is no one regulatory body (such as a charity commission) that determines what is a charity.⁶

6.3 The one unwavering requirement for a charity is that it must have a primary purpose that is charitable. However, even the concept of a "charitable purpose" is unclear. The basis for

⁴ Media Release 7/6/2008, Australia Bureau of Statistics, 5 Aug 2008

⁵ Australian Bureau of Statistics, "Australian National Accounts: Non-Profit Institutions Satellite Account, 1999-2000 at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/productsbyCatalogue/A41A434D8A63A4DCCA256C7E0076ABE2?OpenDocument>

⁶ Changemakers Australia 'The State of Play – Charitable Law Issues' Changemakers Australia, 15 June 2008.

the modern law of charity is Pemsel's Case⁷ which in 1891 established the four "heads" of charity. They are:

- relief of poverty;
- advancement of education;
- advancement of religion; and
- other purposes seen as beneficial to the community which do not fit into the first three categories.

Charitable purposes must also be for the public interest.

6.4 However, there is a strong view, with which we concur, that the first three heads – of poverty, education and religion – do not adequately cover what many people today would regard as core charitable activities while the fourth "catch-all" purpose, of being beneficial to the community, is so vague that it is of little use.⁸

7. Taxation legislation and the ATO – default regulators of charity law in Australia

7.1 The Income Tax Assessment Act 1997 (Cth) (**ITAA97**) has become the default regulation of charities in Australia. In regulating the collection of income tax, the ITAA97 provides a list of entities exempted from such taxes as well as a means for gaining such exemption via application to the Australian Taxation Office (**ATO**). The ITAA97 also governs deductions such as the provision of "deductible gift recipient" (**DGR**) status for applicable NFP entities.

7.2 The list of specifically exempted entities and general categories which are entitled to receive tax concessions has grown in an arbitrary manner over time. There has been no coherent public policy underpinning the development of these categories of tax concession and of the NFP sector in general.

7.3 By overseeing these areas of tax exemption, the ATO has effectively become a gatekeeper, determining which organisations receive charitable status. NFPs must fit into one of the specified but somewhat ad hoc categories of tax concession. If not, they must be specifically named which requires amendment to legislation and is, therefore, only available to those NFPs with enormous political influence.

⁷ Commissioner for Special Purposes of Income Tax v Pemsel [1891] AC 531

8. Problems with existing regulatory environment

8.1 Overview

- (a) Application procedures for charitable endorsement are too complex for lay people. Categories of entities entitled for tax concession are still derived from the nineteenth century proclamation of the “four heads of charity” delineated in Pemsel’s Case. Such development has created two fundamental concerns:
- charitable law has become out of step with contemporary opinion; and
 - characterisation of valid charitable purposes has become so complex that it is difficult for lay people to make application for endorsement without the assistance of a lawyer.

8.2 Charitable law out of step with contemporary opinion

- (a) As stated earlier, current classifications and categories of charitable purpose have evolved from case-based jurisprudence developed over four hundred years. As a result, many NFPs that would be considered charitable entities in today’s society are not able to receive the benefit of being considered a charity for taxation purposes.
- (b) Entities seeking endorsement also have trouble distinguishing between NFPs which receive tax concessions and other similar NFPs which do not. For example, scout groups as compared with youth groups and other recreation associations, and the variable treatment of neighbourhood houses.
- (c) The National Roundtable of Nonprofit Organisations recognises that “a respectful body of opinion exists [professing] that the law lags behind public understanding of what should be regarded as charitable”⁹. This means newly emerging “public good” organisations that are charitable in nature, are denied charitable status while “entities, that were once considered charitable but may no longer be considered so, are likely to remain on the register”¹⁰. For example entities created by religious groups retain DGR status even when they are engaged in commercial activities, while groups advocating civil and human rights and amateur sports clubs are not considered charitable.¹¹

⁸ Changemakers Australia ‘The State of Play – Charitable Law Issues’ Changemakers Australia, 15 June 2008.

⁹ National Roundtable of Nonprofit Organisations, “The assessment of charitable status in Australia: Current practice and recommendation for improvement.” National Roundtable of Nonprofit Organisations, 2007.

¹⁰ ACOSS, VCOSS, et al., ‘Charity Now: Refining Law for the New Millenium, 2006

¹¹ Changemakers Australia ‘The State of Play – Charitable Law Issues’ Changemakers Australia, 15 June 2008

- (d) In 2001 the Inquiry into the Definition of Charity (**CDI**) conducted investigations into reviewing the legal concept and definition of charity, the registration of charitable organisations and the ongoing monitoring and regulations of the activities of charitable entities.¹² The final CDI report recommended modernising the definitions of charitable purposes to include the advancement of social or community welfare, the advancement of culture and the advancement of the natural environment. Recommendations from the report are still yet to be implemented.

8.3 Characterisation of valid charitable purposes too complex

- (a) The unnecessarily complicated taxation regime for charities and the broader group of NFPs is explained succinctly by Melbourne University academic, Ms Ann O'Connell, in her article 'The tax position of charities in Australia - why does it have to be so complicated?' (2008).¹³
- (b) Obtaining tax concessions for NFPs is becoming an increasingly complex task. Understanding the characterisation of charitable purposes which entitle NFPs to charitable concessions has become so complicated that it is difficult for lay people to make application for endorsement without the assistance of a specialist lawyer.
- (c) Even NFPs which do fall within the legal definitions of charity still find current charitable concessions applications so complex and confusing that they need to seek legal assistance. For example, the highly technical distinction between the definition of the "health promotion" and "harm prevention" DGR categories in the current regulations are difficult for lay applicants to understand.
- (d) Currently, NFP applicants need to complete a number of different, but similar looking, ATO forms. For example income tax concession and DGR forms are very similar in appearance and have similar content. NFPs often do not realise that these are in fact separate application forms which require completion at different stage of the tax concession application process.
- (e) Recently, the Commissioner of Taxation, Michael D'Ascenzo, acknowledged in the Australian Taxation Office's Compliance Program 2008-09, that even though "non-profit organisations show a strong desire to get it right, they often have a low level of knowledge about how the tax and superannuation systems work"¹⁴.

¹² Inquiry into the Definition of Charities and Related Organisations, 2001, Chp 25: <http://www.cdi.gov.au>

¹³ (2008) 37 Australian Tax Review 17-37

¹⁴ Australian Taxation Office, 'Compliance Program 2008-09', Australian Taxation Office, Canberra, August 2008
http://www.ato.gov.au/content/downloads/COR_0015516_CP0809.pdf

- (f) At PilchConnect 40% of the requests we receive for assistance from NFPs relate to eligibility, and the process for obtaining or disputing, tax concessions – in particular, DGR status. Nearly all applicants are confused about the terminology and the categories that exist. Some within the same ‘group’ of organisations have different success in obtaining DGR or TCC status depending on which local ATO office they have applied to. For a good example of the difficulties faced by a NFP, please refer to the submission by the Human Rights Arts and Film Festival to the Senate Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations.¹⁵

8.4 Inconsistencies and incompatibility between federal and state legislation

- (a) Incompatibility between federal and state legislation has presented difficulties for NFPs which are regulated by a number of different government agencies across different jurisdictions.
- (b) For example regulations recently created by the Victorian Office of the Housing Registrar exposed NFPs wishing to register as “housing agencies” to the possibility of forfeiting their DGR status. Because both the ATO and the Office of the Housing Registrar required divergent and inconsistent content in winding up clauses of governance documents, without careful legal drafting, many organisations registering as “housing agencies” risked losing their DGR status.¹⁶

9. Conclusions and recommendations

9.1 Conclusion

- (a) Without specialist legal advice it is very difficult for NFPs to access the tax concessions that they are entitled to under the current regime. NFP entities find it difficult to understand whether they are entitled to tax concessions, what those tax concessions are and how to apply for the tax concessions. Such frustrations have been best enunciated by NFP peak organisation, the National Roundtable of Non-Profit Organisations:

It is in tax law that the greatest confusion is to be found. There are a great variety of concessions given by different levels of government, each to a variety of nonprofit organisations. It is impossible to find any set of principles underpinning the legislation that designates these concessions. There are no clear links between the concessions provided and public disclosure

¹⁵ Human Rights Arts and Film Festival submission to the Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations: http://www.aph.gov.au/Senate/Committee/economics_ctte/charities_08/submissions/sub133_pub.pdf

¹⁶ See p. 20 PilchConnect submission to the Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations: http://www.aph.gov.au/Senate/committee/economics_ctte/charities_08/submissions/sub129.pdf

requirements. Not surprisingly, in such an environment regulation is confusing, contradictory and often unfair.¹⁷

- (b) The Australian NFP sector requires one overall simplified tax exemption scheme that is underpinned by a rational basis for the determination of charitable entities. Taxation exemptions should provide support to Australia's NFP sector rather than create a barrier by continuing to institute a complex and inconsistent regulatory framework.

9.2 PilchConnect recommendations

- (a) Any taxation reform should be underpinned by a rational basis for charity and NFP taxation exemption and other fiscal initiatives. The current system no longer has this underpinning.
- (b) An application process should be created so that charities and NFPs may apply for all forms of tax exemption within one application.
- (c) In broad terms, PilchConnect endorses the recommendations made by the *Inquiry into the Definition of Charity 2001* and urges the Senate Inquiry to refer the recommendations made by the *Inquiry into the Definition of Charity* to a specialist committee for implementation.

¹⁷ National Roundtable of Nonprofit Organisations, 'Nonprofit Regulation Reform Program' National Roundtable, May 2004. <http://www.nonprofitroundtable.org.au>