



CHARTERED SECRETARIES
AUSTRALIA

Leaders in governance

6 July 2011

Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: NFPreform@treasury.gov.au

***Better targeting of not-for-profit
tax concessions***

Chartered Secretaries Australia welcomes the opportunity to comment on the consultation paper, *Better targeting of not-for-profit tax concessions* (the consultation paper).

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency. Our members are all involved in governance, corporate administration and compliance with the *Corporations Act* (the Act). Many of our members serve as officers of not-for-profit (NFP) organisations, or work for or are involved with companies limited by guarantee. CSA itself is a company limited by guarantee, formed to serve the interests of its members, who are governance professionals. We have drawn on their experience in the formulation of our submission on the matters canvassed in the consultation paper.

General comments

CSA strongly supports regulatory reform of the NFP sector. The NFP sector has traditionally been under-resourced and subject to complex compliance provisions, including those covering the assessment, granting and monitoring of concessional tax treatment. The initiative to streamline and simplify the process, therefore, is likely to improve understanding and reduce compliance costs for NFPs.

It has been evident through comparative corporate law reforms for the private sector, introduced over the past decade or so, that reform within the NFP sector has been lacking. This has been particularly disappointing, given the importance of this sector within the Australian economy and its contribution to the community.

CSA has responded to previous reviews and inquiries noting that the NFP sector requires a coordinated and holistic approach to reform. CSA welcomes and supports the establishment by the Federal Government of the Australian Charities and Not-for-Profits Commission (ACNC) and

the appointment of the new chair of the advisory board¹ assisting the ACNC, as these are measures which will go some way towards achieving this goal. CSA recognises that a dedicated regulator, streamlined reporting and a national regulatory framework are key areas of restructuring which can support the altruistic activities of the NFP sector.

However, CSA does not believe that the introduction of taxation reform, as discussed in the consultation paper, is consistent with this approach. The new regulatory body, the ACNC, has as its major task the simplification of the regulation and reporting requirements of NFP organisations, with particular emphasis on good governance practice compatible with ensuring that scarce resources are efficiently and effectively utilised for the official objectives of NFP organisations. The taxation measure proposed in the consultation paper, which is probably designed to capture a small number of NFPs, is going to undermine the new NFP initiative by placing significant administrative burdens on all NFPs, including small NFPs which often lack the technical skills to handle complex administrative matters. The timing of the new taxation measure will make it more difficult for the ACNC to gain the cooperation of the NFP sector.

CSA fully supports the scope of the national regulator being to regulate all NFP organisations. We have previously recommended that the extent of regulation could then differ according to the size of the organisation. CSA strongly believes that this is a process which should be under the ambit of the ACNC and not be approached in a piecemeal fashion, that is, through reform to taxation.

Transparency and accountability in NFPs

The consultation paper refers in many instances to the need to 'level the playing field' and ensure that tax concessions are appropriately targeted. CSA is of the view that the argument that the playing field between NFP and for-profit organisations is not level is flawed, given that for-profit organisations are free to distribute their profits as they see fit, whereas NFP organisations are not. To base reform of the NFP sector on a misapprehension that the private and NFP sectors can and should be treated in similar fashion defeats the objectives of providing a regulatory framework for the NFP sector that takes into account its specific characteristics and needs.

Furthermore, given that the clear subtext of the consultation paper is an underlying focus on transparency and accountability, that is, the governance of NFP organisations, CSA submits that any proposed reform should be focused on governance and risk management principles and frameworks, rather than on taxation treatments.

There is, undoubtedly, a need for confidence in the governance of NFPs and propagation of the idea that governance should not be strictly limited to the operation of 'for-profit' companies. NFP organisations have a multiplicity of often complex stakeholder relations to consider (for example, members, volunteers and grant makers — government, private foundations, corporate, the general public). CSA believes that members and stakeholders of all NFP organisations should be able to have access to information that allows them to know the financial position of the organisation, that the organisation is being managed prudently, that the allocation of resources is aligned with the values and objectives of the organisation as set out in its constitution, and that the relevant processes are in place to manage the organisation.

However, the legal and regulatory framework currently in place has been devised for for-profit companies and does not assist the information needs of stakeholders in the NFP sector. CSA is of the opinion that the attempt to reform taxation in isolation does not address this problem, and will undermine the potential of the ACNC and overall development of the NFP sector.

¹ The Hon Bill Shorten MP, 'Next Stage for Not-for-Profit Reforms Announced' (Press Release, 27 May 2011)

Furthermore, CSA reaffirms that it does not believe that taxation amendments are adequately geared to consider or promote the governance issues of accountability and transparency in relation to the creation and distribution of any profits of NFP organisations.

CSA strongly recommends that the government postpone any changes to the taxation arrangements of NFPs and not undermine the potential of the ACNC to provide a holistic regulatory framework for the NFP sector.

With these considerations in mind, CSA provides the following submission addressing the options provided in the consultation paper.

We would welcome the opportunity to discuss any of our views in greater detail. Please call me if you would like to set up a meeting. I can also arrange a meeting with our Members.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style.

Tim Sheehy
CHIEF EXECUTIVE

1 The 'overs' and 'unders' of administering NFPs

The over-administration of NFPs

Taxation forms just one element of the overall compliance and reporting matrix that rules over the NFP sector. In a major survey of NFPs entitled *Accountability and Corporate Governance in Not-for-Profit Companies* (the Woodward Report) conducted in 2004 by the Centre for Corporate Law and Securities Regulation at the University of Melbourne², it was noted that there is a 'confusing mix of state and federal regulation and regulators, and a lack of nationally consistent reporting obligations'³.

Implicit in this observation is the underlying reality that NFPs are required to undertake extensive administrative processes in order to comply with their reporting and taxation obligations. NFPs will usually have regard to the sometimes competing concerns of a range of organisations such as funding bodies, the Australian Taxation Office and state departments administering the Fundraising/Collection Acts or providing government funding, as all such parties have disparate requirements of NFP organisations, which results in a great deal of duplication of disclosure obligations.

For many NFP organisations, particularly smaller NFPs, this incurs compliance costs for little or no benefit. The onerous burden of administration requires an investment by the NFP in many different business components, with very little benefit flowing to the various stakeholders, or importantly, the target audience. Corporate and reporting administration is not always a simple task and can be very time and cost-consuming, with organisations required to employ, train and develop competent staff, and invest in infrastructure such as computer-based systems and record-keeping arrangements.

CSA notes, however, that these processes are not reflected in the *Options* addressing *Entity structure* discussed in the consultation paper. Instead, the consultation paper recommends that NFPs will have to undertake complicated and time-consuming processes to prove that their commercial activities further their altruistic objectives. It is ambiguous as to whether NFPs will have to continually undertake those processes to prove that their commercial activities further their objectives, which introduces the potential for an ongoing compliance burden unknown in the for-profit sector.

The paper then suggests three options for the targeting of tax concessions, all of which are equally burdensome for the NFP organisation and add to the already complex compliance environment in which NFP organisations currently operate. In the first and second instances, the NFP needs to invest in set-up, legal and accounting costs in order to establish a separate 'entity' to administer the unrelated commercial activity. In the final instance, the NFP is required to restructure their organisation in order to comply with the requirement. The likely outcome in all *Options* is the incursion of substantial cost and disruption to work output for minimal or zero gain. Furthermore, given the inherent complexity of creating and maintaining separate entities which *of themselves* do not further the objectives of the NFP organisation, CSA contends that all three options force poor corporate administration on NFP organisations. Poor corporate administration does not provide for either good governance or good risk management outcomes.

The administrative burden will also have a flow-on effect on the diversification arms of the NFP. While the consultation paper promulgates the assertion that the targeting of tax concessions will not prevent NFPs from innovating and diversifying; the reality is that the proposed *Options* will

² Woodward and Marshall, *A Better Framework: Reforming Not-For-Profit Regulation*, 2004, The University of Melbourne (available at: <http://cclsr.law.unimelb.edu.au/not%2Dfor%2Dprofit/finalreport/>)

³ *Ibid* at p 1

neither promote nor encourage these processes. CSA believes that the *Options* will add complexity to the organisation of NFPs and in fact discourage NFPs from engaging in innovation and diversification, as resources will be diverted to managing the corporate administration imposed by the proposed reforms.

A good example of this is to consider the practical implications of a NFP organisation setting up a new entity in order to meet taxation requirements. While this process would clearly define the separate incomes for the relevant entities for taxation purposes, the realistic effect would be additional corporate administration and compliance complexity, putting further strain on the existing staff. As most NFPs only have a limited number of people within their organisation with the expertise and knowledge to undertake the corporate administration required for compliance of the organisation with multiple obligations, many NFPs will be forced to seek external legal and accounting advice. This would deplete the already limited financial resources and divert those resources away from the objective for which the NFP was created.

Undermining the NFP regulator

CSA concurrently believes that the proposed reforms in the consultation paper will do more than simply lead to poor corporate administration internally and over-administration externally of the NFP sector. The proposed reforms will also undermine the role of the new NFP regulator, the ACNC.

CSA has previously submitted that the current arrangements with respect to reporting place an extraordinary level of complexity on the disclosure regime of NFPs. Such complexity neither assists the delivery of services for which the NFP was established (given the allocation of scarce resources to fulfilling reporting obligations), nor stakeholder information needs, as the key information which is of concern to those with an interest in the NFP can be difficult to locate.

There is the need, therefore, for the harmonisation of oversight of NFPs. CSA notes that this needs to be an all encompassing redress of the current model including the process for registering NFP organisations; educating the sector and encouraging compliance; educating the public about the role of NFP organisations; and developing and maintaining an accessible, searchable public information portal.

The government⁴ has already indicated its intent to provide for a national regulatory framework, with the ACNC due to commence work in 2012. The government has stated that:

From 1 July 2012, the Australian Charities and Not-for-Profits Commission will initially be responsible for determining charitable, public benevolent institution, and other NFP status for all Commonwealth purposes; providing education and support to the sector; implementing a 'report-once use-often' general reporting framework for charities; and establishing a public information portal by 1 July 2013.

In line with this mandate, CSA believes that the ACNC should be given the opportunity to be established, assess the legal status of groups seeking charitable status and NFP benefits such as tax concessions and make determinations as to NFP status, with the role of the Australian Taxation Office being to collect tax according to the status granted to an organisation.

Seeking to make changes to the taxation concessions of NFPs before the sector's regulator has been set up will greatly undermine this process. CSA points to the taskforce set up by the government to advise on NFP regulatory reform and the advisory board assisting the ACNC as

⁴ The Hon. Bill Shorten MP, 'Next Stage for Not-for –Profit Reforms Announced' (Press Release, 27 May 2011)

providing the government with access to a wealth of expertise and knowledge of the NFP sector to call on.

CSA suggests that the thinking behind the consultation paper is embedded in the existing regulatory framework, which has seen the Australian Taxation Office responsible for determining NFP status. However, the move to a dedicated NFP regulator is recognition of the call from the NFP sector over many years that the Australian Taxation Office is not the appropriate regulator to best foster the aims of the sector. The assumption that underpins the consultation paper is that clarifying the taxation treatment of the NFP sector is the key to appropriate regulation, despite the advice from the sector that it is only a minor part of the regulatory framework it requires. CSA recommends that any reform at this stage not be based on taxation treatment, as this simply replicates the current approach, which the sector has advised is not best suited to its needs. It is for this reason that CSA recommends that the government postpone the consultation with respect to tax concessions, to provide for the ACNC to undertake its regulatory role.

Recommendation 1: Consultation in relation to tax concessions for NFPs be postponed

CSA recommends that the government postpone the consultation with respect to tax concessions, to provide for the ACNC to undertake its regulatory role and participate in any determination as to the taxation treatment of NFPs.

2. NFP reform, taxation and governance

Diversity within the NFP sector

The consultation paper notes that the NFP sector consists of approximately 600,000 entities ranging from large high-profile organisations to small community-based societies. According to the Non-Profit Roundtable, there are as many as 700,000 NFP organisations in Australia⁵.

Each of these different organisations is also likely to be structured under a myriad of legal structures within which NFPs currently operate (incorporated association, company limited by guarantee, proprietary company, trust, cooperatives, Royal Charter, special Act of Parliament, aboriginal corporations).

The result is a particularly diverse field of NFP organisations with different charitable, altruistic and social purposes, including associations (CSA is one such association), hospitals, community services, universities, sports clubs, religious groups, day care centres, recreation clubs, environmental groups, job-training centres, family counselling agencies, and many more.

This introduces confusion as to compliance obligations, inefficiencies in regulatory compliance, and considerable reporting duplications. CSA believes that the diversity in the operation of NFPs, coupled with the disjointed NFP regulatory schema means that using a standard form, that is, a taxation rule change, to address these complex issues is unlikely to achieve the desired effect of reduced regulatory and reporting obligations.

CSA believes that, despite the additional problems which taxation reform might create, it is also likely that the reforms would still not address the key changes which the consultation paper seeks to implement, that is, informing stakeholders about the use of funds.

⁵ National Roundtable of Non-profit Organisations, *The Non-profit Sector in Australia: A Fact Sheet*, Downloaded on 21 June 2011 from www.nonprofitroundtable.org.au

Transparency and accountability

The consultation paper suggests that taxation reform is targeted at ensuring that the altruistic endeavours of the sector are not diverted to supporting unrelated commercial activities in which NFPs may choose to engage. CSA recognises that the concerns raised within the consultation paper are, in effect, concerns with issues of transparency and accountability within NFPs. These are governance and risk management concerns, not taxation issues.

CSA understands that the government and other stakeholders are seeking to ensure that interested parties in NFPs do not divert profits from the organisation and the achievement of its altruistic objectives. Stakeholders of various NFPs, including the government, want to be sure about the financial position of any NFP organisation, that the organisation is being managed prudently, and that the allocation of resources is aligned with the values and objectives of the organisation as set out in its constitution.

CSA has already noted that the issues surrounding disclosure to stakeholders about the financial position and management of the organisation cannot be adequately addressed through reforming taxation requirements. Those issues can, however, be addressed through the application of sound governance principles, which involve stewardship, accountability, transparency and integrity.

CSA believes that governance means the method by which an organisation is run or governed, over and above its basic legal obligations. It has four critical elements:

- **transparency**, which entails a true dialogue with a range of stakeholder groups. The starting point is transparency of purpose, clarifying why the organisation exists, what its objectives are and what the measures of achievement are. It also means transparency of process so that all stakeholders understand how things are done as well as why
- **accountability** — this means asking the questions: Who is responsible and to whom? What are they responsible for? What are the consequences if the rules are violated? It is a normal part of the exercise of responsibility. It is a reporting mechanism enabling those conferring responsibility to monitor its exercise
- **stewardship**, which involves a clarity in all organisational decision-making so that those controlling the destiny of an organisation do so not for their own benefit, but rather for the benefit of the range of individuals and groups who have an interest in the affairs of the organisation, that is, the stakeholders
- **integrity** — developing a culture committed to ethical behaviour. That culture should be about carrying out the responsibilities required by the charter, legislation or constitution in a manner open and apparent to all stakeholders; being accountable for those actions; acknowledging that the good of others overrides any benefit to oneself; and acting ethically.

Transparency of reporting of related-party transactions and conflicts of interest will capture the information that stakeholders require to assess if the profits of NFP organisations are being inappropriately diverted to interested parties. Should disclosure reveal any inappropriate activity, it is for the ACNC, as the regulator, to undertake appropriate enforcement.

CSA is of the view that how NFP organisations make a profit is not the issue. The distribution of that profit is the issue. Indeed, CSA considers that the government should encourage the profitable arms of NFPs so that they do not call on government funding. The government should also encourage NFP organisations to continue to enter into commercial partnerships to generate funding. However, there is a commensurate need to ensure that there is clarity as to the application of those profits.

For example, an NFP organisation may have assets in the form of land. Under the proposed changes canvassed in the consultation paper, the NFP could only retain the land as a passive investment that does not generate funding or sell it until there was none left. CSA contends that there should be strong support for the NFP leveraging the asset, for example, by building a retirement home that generates profits that are in turn used to foster the objectives of the NFP organisation. However, the NFP should also be required to disclose how the profits are applied.

CSA notes that such accountability could be fostered by requiring a short-form report from all NFPs, with further disclosure and reporting required of some NFPs according to size. This short-form report could be a one or two-page document.

This minimum standard of governance disclosure should be publicly available so that any person seeking to engage with the NFP organisation in any capacity has access to the information. Every NFP organisation, no matter where it is registered in Australia, should apply the same rules and every NFP organisation should be treated in the same manner in relation to this short-form report.

Recommendation 2: Minimum standard of governance disclosure

CSA recommends a mandatory, short-form report for all NFP organisations, which would be publicly available, that would cover:

- statement of objectives of NFP organisation
- the amounts and sources of funding
- the activities that the fundraising supports
- the processes in place, including the risk management processes, which ensure the proper management of all fundraising, activity support, expenditure, and staff and volunteers
- details of directors and secretary(s) and their remuneration (including information on whether non-executive board members are paid, the time commitment of directors and whether there are board committees or equivalent)
- disclosure of all related-party interests.

Within the Australian context, these values are largely embodied not only in the Corporations Act but also in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* which provide the appropriate governance guidance to the Australian corporate regime. CSA envisages a similar but less complex scheme could be applied to the NFP sector through the office of the ACNC.

Any scheme, however, would need to account for the aforementioned diversity of the sector, while also noting that it is common for the directors of NFP organisations to come from backgrounds which carry no experience in organisational administration, financial administration or business management in general. As such, fulfilment of their legal, reporting, and taxation responsibilities as directors will be much more difficult. A failure to know those responsibilities is not an acceptable defence after something goes wrong.

It is in the manner of the exercise of their responsibilities in supervising employed managers and staff that directors are most likely to fall into breach of those responsibilities. This can occur not through deliberate intent, or through reckless disregard, but most likely from inadequate reporting, both financial and operational, which equates to inadequate supervision of managers and use of inappropriate administration procedures. The more limited the knowledge and experience of individual directors in these matters, the greater the risk of misadventure.

The key concepts of transparency, accountability, stewardship and integrity remain the cornerstones of governance. On this basis, CSA does not believe that reform to taxation standards will address these elements of the disclosure process. Rather the onus remains on NFP boards to ensure that the organisation is fit for purpose and provided with strategic

direction to enable it to attain its stated goals; but also that any change to the organisation is culturally implemented, rather than administratively imposed.

Investing in clearer guidelines and information to assist NFPs with reporting proper financial statements is an essential tool to ensuring good governance and an understanding of risk management. This will inevitably be reporting that appeals to the multiplicity of often complex stakeholders for the NFP and informs them of the processes in place to manage the financial position of the NFP. The ACNC can assist with the education required on this front.

Conclusion

The need for a differentiated governance framework is self-evident in the design and structure of the consultation paper. CSA reiterates its belief that the best way to reform the NFP sector is to consider the sector in its entirety. The move to reform taxation before the ACNC is properly established will undermine the ability of the regulatory body to fulfil its mandate.

The proper allocation of tax concessions is in an important consideration; however, CSA believes that it is only one part of the overall picture which would impact heavily on the other aspects of NFP operation, that is, legal structures, reporting, and infrastructure.

The diversity of the NFP sector demands that a holistic view of reformation is undertaken and **CSA strongly recommends** that, in the first instance, the government should postpone any changes to the taxation arrangements of NFPs and not undermine the potential of the ACNC to provide a holistic regulatory framework for the NFP sector.